REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FORTUNE TOBACCO CORPORATION,
Petitioner,

-versus -

C.T.A. CASE NO. 4587

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
NOV 23 1994

x- -x

D E C I S I O N

This is a petition contesting a deficiency specific tax assessment on the importation of stemmed-leaf tobacco in the amount of P28,938,446.25 covering the period from January 1, 1986 to June 30, 1989.

Petitioner, Fortune Tobacco Corporation, is a domestic corporation engaged in the manufacture of cigarettes.

On September 22, 1980, as an offshoot of the investigation conducted by the Bureau of Internal Revenue to determine whether or not stemmed-leaf tobacco is subject to a specific tax of P0.75/kg. under Section 141 of the Tax Code, petitioner, through counsel, submitted a position paper regarding the non-taxability of stemmed-leaf tobacco it used in the manufacture of cigarettes.

On January 16, 1990, petitioner received from respondent, a letter dated November 24, 1989, rejecting petitioner's argument of its position that stemmed-leaf tobacco is not subject to the P0.75/kg. tax levied under Section 141 of the Tax Code and demanding payment of the amount of P28,939,446.25 as deficiency excise tax on the importation of tobacco strips from January 1, 1986 to June 30, 1989.

In answer to this demand letter, petitioner, on January 25, 1989, disputed the points raised in respondent's letter dated November 24, 1989 and requested reconsideration and withdrawal of the demand for payment.

On August 31, 1990, respondent stood pat on his decision on the taxability of partially manufactured tobacco, more particularly stemmed leaf tobacco.

Hence, this appeal.

In his Answer to the Petition, respondent considered stemmed leaf tobacco, subject of the deficiency tax assessment, as "partially manufactured or prepared tobacco" as provided for in Revenue Regulations 17-67 [Section 1(1)]. Thus, it is subject to a tax of P0.75 for each kilogram (Section 141, NIRC). He further averred that Section 137 of the Tax Code pertains to the transfer of stemmed leaf tobacco as raw materials from one manufacturer of tobacco products (L-7) to another manufacturer of tobacco products (L-7). Revenue Regulation No. V-39, Sec. 20 thereof, refers explicitly to transfer from one L-7 directly to another L-7, but not from L-6 (stripper or thresher) to L-7. While imported leaf tobacco has never been subject to tax, partially manufactured tobacco is subject to the specific tax of P0.75/kg.. Finally, that the assessment in question was issued in accordance with law and revenue regulations and all presumptions are in favor of the correctness of the assessment.

When this case was called for hearing on October 25, 1991, petitioner submitted as its evidence, the following documents duly marked during the previous hearing, to wit:

> The letter of respondent dated November 24, 1989 demanding from petitioner the payment of P28,928,446.25 as deficiency excise tax on the importation of tobacco strips (partially manufactured tobacco) covering the period from January 1, 1986 to June 30, 1989, exclusive of interest (Exh. "A");

The letter of Atty. Abraham C. La Vina, addressed to the Commissioner of Internal Revenue, dated January 25, 1990 requesting the reconsideration and withdrawal of the demand for payment made in respondent's letter dated November 24, 1989 (Exh. "B");

The letter of respondent dated August 31, 1990, rejecting petitioner's arguments contained in the letter dated January 25, 1990 and categorically stating that "this is our final stand on the matter and we may not consider any more further request for reconsideration" (Exh. "C").

All these exhibits were admitted by the Court without objection on the part of respondent. No testimonial or other evidence was offered by petitioner.

Respondent in turn submitted and formally offered as its evidence the following documents which form part of the BIR records:

Worksheet of petitioner's Imported Partially Manufactured Tobacco and Computation of Specific Tax per Sec. 141(A), NIRC, prepared by Rufo Gauna, Norvin A. Dilao, Dario B. Roxas and Enrique Z. Bueno, Revenue Enforcement Officials, covering the period from January 1, 1986 to June 30, 1989 (Exh. "1");

Report of Investigation by the same Revenue Enforcement Officials (Exh. "2");

Memorandum Report on investigation/stocktaking of cigar and cigarettes for excise tax/inspection purposes (Exh. "3");

> Letter of respondent dated November 24, 1989, maintaining that stemmed leaf tobacco is subject to the specific tax of P0.75/kg. under Section 141(b) of the Tax Code and demanding that petitioner pay P28,938,446.25 as deficiency excise tax for the years in question exclusive of interest and surcharge (Exh. "4");
>
> Letter of respondent dated August 31, 1990 holding steadfast to his decision that stemmed leaf tobacco is subject to specific tax (Exh. "5");
>
> Letter of respondent dated October 17, 1990, addressed to petitioner demanding payment of P28,938,446.25 representing deficiency specific tax, exclusive of increments for the period in question (Exh. "6");
>
> Stamp Received portion of Exh. "6" (Exh. "6-a");
>
> Letter of respondent addressed to petitioner's counsel reiterating the demand for payment of deficiency tax including interest (Exh. "7").

Said exhibits were likewise admitted by the Court. Upon respondent's motion, however, Exh. "7" which had earlier been admitted was stricken from the records of the case on the ground that said exhibit refers, not to the present controversy but to C.T.A. Case No. 4616.

Respondent filed his memorandum on January 29, 1992 where he further challenged the Court's jurisdiction over the case. Petitioner filed its memorandum on February 10, 1992.

On January 29, 1993 the court *motu propio* promulgated a resolution ordering the reopening of the case, for the parties to disclose "more facts and data necessary to the final disposition of the issues", such as:

a) the circumstances surrounding the purchase of imported leaf tobacco

b) the source or from where and whom it was purchased from, whether it was purchased directly from a manufacturer of tobacco products (L-7) or from a manufacturer or wholesale leaf tobacco dealer also known as stripper (L-6).

On March 5, 1993, respondent filed with the Court a consolidated supplemental memorandum.

On March 15, 1993, hearing of this case for reception of additional evidence was consolidated with that of C.T.A. Case No. 4616 involving the same parties and presumably involving similar issues, pursuant to the resolution of January 29, 1993. The Court was informed of the death of Atty. Abraham C. La Vina, petitioner's counsel of record, with no one to represent for the petitioner in said hearing.

Respondent presented one Enrique Z. Bueno, Assistant Chief of the Tobacco Tax Division of BIR. He testified that in 1989 he was assigned to the Field Operations Division which was in charge of investigation relative to the payments of excise taxes and inspection of manufacturer of exciseable products. The witness further stated that he was one of the Revenue Officers who was assigned to conduct the stock-taking in the factory of the petitioner. The team submitted a Memorandum Report, dated November 21, 1989.

As part of their stock-taking procedure, the team went over the books of the petitioner first. There is a L-7-$^{1}/_{2}$ official register book where all the tobacco raw materials purchased are entered. The L-7 book records all raw material and finished products. Both imported and locally grown tobacco are first recorded in the L-7-$^{1}/_{2}$ record book.

In the memorandum report which witness Bueno stated his team submitted to the Chief of the Field Operations Division, they found and ascertained a total of 38,584,595 kilograms of imported tobacco which was taken from the L-7-$^{1}/_{2}$ official register. In the same register are also recorded locally grown tobacco, and even such categories as Virginia, Burley, some turkeys (sic) grown in San Jose, Mindoro. This witness concluded his testimony by stating that stemmed leaf tobacco, where the midribs are removed either by stripping or by use of threshing machine is partially manufactured tobacco having been done abroad or from where it came from.

Atty. Rustus Raymundo entered his appearance for petitioner on April 30, 1993. During the hearing set anew by the Court on July 15, 1993 for the continuation of reception of "additional evidence", petitioner's new counsel did not appear. The Court granted respondent's oral motion that petitioner was deemed to have waived its right to cross-examine respondent's witness who testified on March 15, 1993.

Again, another development transpired. Atty. Raymundo withdrew as counsel for petitioner on July 16, 1993 and Atty. Alfonso M. Cruz entered his appearance for petitioner on August 16, 1993. During the hearing set on September 10, 1993 for the same purpose, petitioner's counsel's earlier motion to postpone said hearing was denied and petitioner's right to present additional evidence, if any, was considered waived. Petitioner did not submit supplemental memorandum in spite of the order of the Court on September 23, 1993. The case was then considered submitted for decision on November 24, 1993 after petitioner failed to file its supplemental memorandum.

Considering that respondent in his memorandum assailed the jurisdiction of this Court, which may be raised at any stage of the proceedings, we shall first tackle said issue. In this connection, respondent contended that petitioner failed to file a protest, as prescribed under Section 229 of the Tax Code and such failure, renders the assessment final, executory and demandable and the taxpayer is forever barred from disputing the assessment.

The argument is not impressed with merit. It cannot be gainsaid that respondent on November 24, 1989, imperatively demanded payment of the amount of P28,938,446.25 as deficiency excise tax on petitioner's alleged importation of tobacco strips (partially manufactured tobacco) covering the period from January 1, 1986 to June 30, 1987 (Exh. "A").. This is definitely a protestable assessment. Thus, the demand for payment was disputed by petitioner in a letter dated January 25, 1990 alleging among others, that imported stemmed leaf tobacco is not subject to the P0.75/kg. tax levied under Section 141 of the Tax Code considering that pursuant to the provision of Section 137 of the same Code, stemmed leaf tobacco "may be sold in bulk as raw material by one manufacturer to another, without payment of the tax", thus requesting the reconsideration and withdrawal of the demand for payment (Exh. "B"). If this is not deemed a protest against the assessment we wonder what is. Evidence will show that respondent held steadfast on his decision on the taxability of stemmed leaf tobacco when he advised petitioner that "this is our final stand on the matter and we may not consider any more further request for reconsideration (Exh. "C").

The bottom line here is, that the avenue for administrative relief has been shut off. Hence, this Court has jurisdiction over the petition for review which assigned several errors committed by respondent in the decision.

We now come to the merits of the controversy. Despite the dearth of evidence on record, this case can be resolved on the interpretation of existing law as to the nature of stemmed leaf tobacco and whether or not it is subject to excise tax.

The issue is not new. The question has already been passed upon in C.T.A. Case No. 4616, promulgated October 6, 1994, involving the same parties herein and the analogous issue, where this Court set aside respondent's assessment of deficiency excise tax on stemmed leaf tobacco principally because under Section 1-b of Republic Act No. 690 entitled "An Act to limit the Importation of Foreign Leaf Tobacco" as amended by R.A. 1194, stemmed leaf tobacco is specifically excluded from the definition of processed tobacco. In the absence of a statutory definition of what is the meaning of "tobacco prepared or partially prepared" we may adopt the definition of law on "processed tobacco" because its definition clearly refers to tobacco being prepared for manufacturing purposes which for ready reference is being quoted below:

> "Section 1-b. By processed tobacco is meant leaf tobacco which is either blended, cased, flavored, ready-cut or cut fillers ready for manufacturing purposes and shall not include tobacco leaf only the stem of which is removed. xxx"

In accordance with the above definition, "processed tobacco" cannot possibly refer to finished tobacco products but to tobacco leaf being prepared so that it will be ready for manufacturing purposes similar to "prepared or partially prepared tobacco". In fact, under Section 2(m) of Revenue Regulation No. 17-67 defining what is partially manufaotured tobacco, "ready-cut or cut fillers" included in the phrase "processed tobacco" is also specifically enumerated, among others, as one type of partially manufactured tobacco. However, the same revenue regulation likewise included "stemmed leaf tobacco" as a type of partially manufactured tobacco which by definition of law is specifically excluded. In case of this conflict, the rule in statutory construction is very clear that said provision of the implementing regulation which is contrary to law is considered null and void and of no effect.

This construction is especially true in the case of tax statutes because statutes imposing tax are strictly construed against the state and liberally in favor of the taxpayer. This is because tax laws operate to impose tax burdens on the public or to restrict them in the enjoyment of their property and the pursuit of their occupation. Thus, in the interpretation of such statutes it is the established rule not to extend their provisions by implication, beyond the clear import of the language employed, or to enlarge their scope as to include matters not specifically pointed out. In case of doubt, they are construed most strongly against the government. (Gould vs. Gould, 62 L. ed. p. 211, cited in the Handbook on Statutory Construction by Ruperto Martin, 1972 ed. p. 193.) This strict interpretation is especially true in the case of specific taxes because these taxes are those imposed on specified articles, such as the taxes on articles mentioned in Sections 123 to 148 of the National Internal Revenue Code (now Sections 126 to 151) (Shell Co. vs. Vano, 94 Phil 389).

Concerning the argument of the respondent that unlike in Section 137 of the Tax Code, stemmed leaf tobacco is not specifically mentioned in the penultimate paragraph of Section 141 as among those not subject to specific tax when used in the manufacture of other tobacco products on which the excise tax will eventually be paid on the finished product and therefore subject to specific tax. This court believes that the legislature has to provide the said exemption in Section 141 because the same section imposes specific tax on those specified items under subletter(c), namely: fine-cut shorts and refuse, scrap, clippings, cuttings, stems and sweepings of tobacco. Stemmed leaf tobacco is not included because in the first place, it is not being taxed specifically under said section. Respondent merely expanded the meaning of "partially manufactured tobacco" to include within the scope of stemmed leaf tobacco by implication contrary to the aforementioned rule on statutory construction.

On the other hand, Section 137 of the Tax Code mentions stemmed leaf tobacco among those not subject to specific tax when sold by one manufacturer directly to another manufacturer. Does it mean when those items mentioned are not sold by one manufacturer to another, these items are already taxable? If our answer is yes, why then are imported leaf tobacco not taxable? Maybe your answer would be because no provision in the Tax Code imposes specific tax on leaf tobacco. And further because it is being used as raw materials in the manufacture of other tobacco products on which the excise tax will eventually be paid. But is it not a fact that stemmed leaf tobacco like leaf tobacco is not also taxable under any provision of the Tax Code and likewise being used as raw materials in the manufacture of other tobacco products on which the excise tax will eventually be paid. Why then will there be a different tax treatment just because one provision of the Tax Code exempts stemmed leaf tobacco from specific tax under certain conditions. Following, the strict rule against taxation as explained above, we cannot imply that stemmed leaf tobacco will be taxable if it failed to meet the condition set forth under said section in the absence of a clear provision taxing the same. The obvious intention of Sections 137 and the penultimate paragraph of Section 141 is not to tax the articles enumerated therein but to exempt them from being taxed when those articles will be utilized in the manufacture of finished tobacco products on which the specific tax will eventually be paid, otherwise, it will lead to double taxation. Although double taxation is not prohibited in this jurisdiction, the same is however being discouraged because of its disincentive effect. In accordance with the cardinal rule on statutory construction, legislative intent must be ascertained from a consideration of the statute as a whole and not of an isolated part or a particular provision above (Aboitiz Shipping Corporation, et al. vs. The City of Cebu, et al., G.R. No. L-14526, March 31, 1965, cited in the Handbook on Statutory Construction by Ruperto Martin, pp. 42-43). The rule has been to exempt raw materials or even semi-finished products from taxes if it will be utilized in the manufacture of articles subject to specific tax. So that under Section 103(e) sale or importation of raw materials to be used by the buyer or importer himself in the manufacture of petroleum products (except lubricating oil and grease) subject to excise tax is not subject to value added tax. Even finished products such as wines and distilled spirits for treatment of tobacco leaf to be used in the manufacture of cigars and cigarettes may be withdrawn from bond free of excise tax pursuant to Section 130 of the Tax Code. Removal of spirits for rectification need not pay excise tax under Section 134 of the same Code and under Section 145(1) & (13), tax credit is granted on feedstock utilized in the manufacture of exciseable articles and naptha shall be subject to zero rating if utilized as raw material in the production of petrochemical products, respectively. Similarly, stemmed leaf tobacco which is basically a raw material in the manufacture of other tobacco products such as cigars and cigarettes on which the specific tax will eventually be paid will have to be exempted also from specific tax. The construction is done pursuant to the spirit of the law or the reason for it. The spirit or intention of the law prevails over the letter thereof. (U.S. vs. Yee Ngee, How, D.C. Cal 105, F. supp. 577, Martin, *op cit*, p. 64).

Granting for purposes of argument that the term "partially manufactured tobacco" includes "stemmed leaf tobacco", the Bureau of Internal Revenue itself pursuant to Section 43(a) of Revenue Regulation No. 17-67, tobacco product regulation, which provides:

> "Section 43. Tobacco exempted from specific tax. - No specific tax shall be collected on the following:
>
> (a) Leaf tobacco and partially manufactured tobacco, except imported leaf tobacco, unless entered in the L-7 official register book.
>
> xxx xxx xxx

(Underscoring supplied, See Revenue Regulations Updated by Prof. Eustaquio O. Ordono, p. 801).

Pursuant to said provision, partially manufactured tobacco including local and imported leaf tobacco shall not be subject to specific tax if entered in the L-7 official register book. This is the book of manufacturer of tobacco. There is no showing that the provisions of Section 43(a) has been superseded by any other regulation. The respondent has no right to rule otherwise because the revenue regulation issued pursuant to law has the force and effect of law unless found to be contrary to law. Furthermore, when a particular construction has been operative over a long period and has acquired the sanction of usage, it is entitled to "respectful consideration" especially if rights have been adjusted and determined by it for many years, as a change may result in inequitable treatment of similarly situated taxpayers and may occur after many persons have acted upon the faith of the Regulation. The rule is also, perhaps, particularly applicable where a change in the administrative construction would produce great administrative inconvenience or inequality. (Law of Federal Income Taxation, Mertens Vol. 1, 1978, Sec. 3.20, p. 40). Long and continuous construction given by government officials entitled to consideration (Phil. Sugar Central vs. Collector, 51 Phil 131). This provision in the regulation may have been the reason why for a long time the BIR has not been collecting specific tax on stemmed leaf tobacco and other partially manufactured tobacco if these articles will be utilized in the manufacture of other tobacco products on which the corresponding specific tax will eventually be paid. Similar appeals from other cigarette manufacturers were filed before this Court involving similar issues.

WHEREFORE, in view of all the foregoing, judgment is hereby rendered setting aside respondent's decision demanding payment of P28,938,446.25 as deficiency excise tax from petitioner. Without pronouncement as to costs.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals