REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

WANDER (PHILIPPINES), INC.
Petitioner,

- versus -

C.T.A. CASE NO. 4721

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JAN 11 1995

x - x

D E C I S I O N

This is an appeal from the decision of the respondent holding the petitioner liable for the payment of the sum of P1,970,246.00 as alleged deficiency income tax and the reduced amount of P192,312.03 (from the original assessment of P311,807.23) representing alleged deficiency sales tax covering the year 1987.

The petitioner is a domestic corporation engaged in manufacturing food products, such as ovaltine, ovaltinees and julep meritene, in the Philippines.

Upon investigation, respondent's revenue examiner found that petitioner is liable for deficiency income and sales taxes for the year 1987. Accordingly, respondent issued against petitioner assessment letters, dated September 27, 1989, received by the latter on November 2, 1989, for alleged deficiency income and sales taxes in the amounts of P1,970,246.00 and P311,807.23, respectively, computed as follows:

1987 - Deficiency Income Tax

Net Income per Return	P34,872,032.00
Add: Taxes & Duties - Capital Expenditures	3,510,564.00
Net Taxable Income	P38,382,596.00
Tax Due Thereon	P13,433,909.00
Tax Paid	12,205,211.00
Deficiency Income Tax	P 1,228,698.00
Add: 20% Surcharge	307,175.00
Total	P 1,535,873.00
Add: 20% Interest from 4-16-88 to 9-21-89	439,373.00
Compromise Penalty	15,000.00
TOTAL AMOUNT DUE AND COLLECTIBLE	P 1,970,246.00

1987 - Deficiency Sales Tax

Net Taxable Sales	P312,987,265.84
Add: Taxable Sales to AFPCES	868,199.47
Adjusted Taxable Sales	P313,855,465.31
Rate of Tax	10%
Tax Due Thereon	P 31,385,546.53
Less: Allowable Tax Credit	22,008,852.71
Tax Due	P 9,376,693.82
Less: Tax Paid	9,187,307.44
Deficiency Sales Tax	P 189,386.38
Add: 25% Surcharge	47,346.59
Total	P 236,732.97
Add: 20% Interest from 4-21-88 to 9-21-89	67,074.26
Compromise penalty	8,000.00
TOTAL AMOUNT DUE AND COLLECTIBLE	P 311,807.23

The corresponding protest was filed by the petitioner on November 23, 1989 pursuant to Section 270 (now 229) of the National Internal Revenue Code. Consequently, on November 26, 1991, respondent rendered her decision denying the protest for deficiency income tax but the original deficiency sales tax originally assessed amounting to P311,807.23 was reduced to P192,312.03 by reason of the tax exemption of the AFP Commissary and Exchange Services (AFPCES) on its purchases from January 1 to March 10, 1987. Respondent's decision was received by petitioner on February 6, 1992.

Hence, the instant petition filed on March 3, 1992, petitioner filed an appeal with this Court praying for the cancellation of the deficiency income tax and deficiency sales tax assessments for the year 1987.

The issues to be resolved are whether or not the petitioner is liable to pay deficiency income tax in the amount of P1,970,246.00 and deficiency sales tax amounting to P192,312.03 for the year 1987

We shall first discuss the 1987 Deficiency Income Tax Assessment issued by respondent against petitioner in the sum of P1,970,246.00, inclusive of surcharge, interest and compromise penalty. The deficiency income tax came about after the examiner disallowed as a business deduction from gross income the amount of P3,510,564.00 representing import duties and compensating taxes paid on various importation of machinery and equipment (classified as fixed assets) by petitioner. It was the contention of respondent that since petitioner capitalized this expense to form part of the acquisition cost of the machinery and equipment the same cannot be deducted outright as an expense for there would be double deduction since petitioner can still claim a deduction from gross income a portion thereof in the form of depreciation expense.

Petitioner, on the otherhand, contends that import duties and taxes are valid deductible business expense pursuant to Section 30(c) of the 1987 Tax Code in relation with Section 80 of Revenue Regulations No. 2. In addition, the BIR has issued BIR Ruling dated February 13, 1976 and BIR Ruling No. 198-83, November 15, 1983, allowing the deductibility of taxes paid in connection with the taxpayer's trade or business. We quote hereunder the provision of law and rulings cited by petitioner, to wit:

1. Section 30(c) of the 1987 Tax Code:

> "SECTION 30. ***Deductions from gross income***. - x x x.
>
> **(c)** ***Taxes***. - **(1)** ***In general***. - Taxes paid or accrued within the taxable year in connection with the taxpayer's profession, trade or business, except:
>
> (A) The income tax provided for under this Title;
> (B) Income, war profits, and excess profits taxes imposed by authority of any foreign country; but this deduction shall be allowed in the case of a taxpayer who does not signify in his return his desire to have to any extent the benefits of paragraph (3) of this subsection (relating to credits for taxes of foreign countries);
> (C) Estate and gift taxes;

(D) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed; and

(E) Electric energy consumption tax imposed by Batas Pambansa Blg. 36."

2. Section 80 of Revenue Regulations No. 2:

"***SEC. 80. Taxes in general.*** - As a general rule, taxes are deductible with the exception of those with respect to which the law does not permit deduction. x x x.

Import duties paid to the proper customs officers, and business, occupation, license, privilege, excise and stamp taxes and any other taxes of every name or nature paid directly to the Government of the Philippines or to any political subdivision thereof, are deductible. *The word "taxes" means taxes proper and no deductions should be allowed for amounts representing interest, surcharge, or penalties incident to delinquency.* x x x."

3. BIR Ruling dated February 13, 1976:

"The custom duties paid by a company on its importation of one (1) unit 1975 Ford LTD-4 door sedan, to be used in the inspection of its project, are deductible from its gross income under Section 30(c) of the Tax Code as implemented by Section 80 of the Income Tax Regulations."

4. BIR Ruling No. 197-83, November 15, 1983:

"In reply thereto, I have the honor to inform you that for income tax purposes, taxes paid or accrued within the taxable year in connection with the taxpayer's trade or business are deductible pursuant to Section 30(c)(1) of the Tax Code as amended. (see also Sec. 80, Rev. Regs. No. 2) Such being the case, your client can deduct from its

> quarterly gross income, such business taxes consisting of the advance sales tax paid on the imported raw materials used in the manufacture of its finished products as well as the sales taxes paid on the said finished products which are sold by it during the taxable quarter. (Sec. 85, Tax Code). Moreover, making such deduction would not involve a change in accounting method requiring the prior consent of the Commissioner of Internal Revenue."

Even assuming that the Capitalized Customs Duties and Taxes were deducted outright as an expense in 1987, still the accounting records of petitioner shows that the same is added back yearly, in equal amounts, to the gross income as reconciling item in computing taxable income for the given year.

We disagree with petitioner.

The petitioner having opted to capitalized the taxes paid on imported machinery and equipment cannot at the same time avail of Section 30(c) of the Tax Code by deducting as a business expense the whole amount paid on import duties and compensating taxes on these importations. To allow such a scheme would in effect grant petitioner the privilege of claiming both the whole amount of taxes and duties paid and a portion thereof by means of depreciation expense spread over the life of the machinery imported. The rulings cited by petitioner refers to importation of raw materials to be used in the manufacture of finished products and not to capital assets used by petitioner in the production of finished products.

Our income tax statute is patterned after the Internal Revenue Acts of the United States, the decisions of the court of the United States interpreting, as well as the rulings of the proper officials in enforcing, their income tax statute have peculiar force in the Philippines. **(Wise & Co. v. Meer, 44 O.G. No. 12, p. 4817; Madrigal v. Rafferty & Concepcion, 38 Phil. 614; Zamora v. Collector, L-15290, 15280; cited by TOMAS P. MATIC, JR., Income Taxation in the Philippines, 1979 Ed., p. 67.)** Our Section 80 of Revenue Regulations No. 2 was patterned after the United States regulations which provides that "import or tariff duties paid to the proper customs officers, and business, license, privilege, excise, and stamp taxes paid to internal revenue collectors, were deductible as taxes imposed by the authority of the United States." However, this has a condition, that is, "provided they were not added to and made a part of the expenses of the business or the cost of articles of merchandise with respect to which they were paid, in which case they could not be separately deducted. The option referred to the *return*, not the *books*; there was no irrevocable election not to take a deduction for import duties in the treatment of such duties on the books as cost of inventory." **(MERTENS, Law on Federal Income Taxation, Vol. 5, S 27.25, Chap. 27 - Page 53.)** This ruling is given great weight and consideration by this Court.

Even assuming as petitioner claims that a reversal of the depreciation charge is added back to income before the computation of the income tax (in the form of retained earnings) still petitioner was able to accelerate its tax benefit in 1987 instead of spreading it for 10 years, the life of the capital assets acquired in 1987. In effect, petitioner had considerably reduced its tax liability for the year 1987 aside from claiming depreciation for a period of ten (10) years. Having been benefited twice for 1987 by claiming a deduction of the whole amount of P3,510,564.00 as well as a deduction of depreciation expense in the amount of P39,661.16, representing depreciation of said machinery during the last quarter of 1987 when these machinery and equipments were imported, in effect prejudice the government of the correct taxes due her from petitioner.

We now go on the issue of whether or not petitioner is liable to pay deficiency sales tax of P192,312.03.

The records show that respondent originally assessed petitioner deficiency sales tax for 1987 in the amount of P311,807.23. After a protest was filed, respondent reduced the amount to P192,312.03, computed as follows: (p. 267, BIR rec.)

"Net Taxable Sales	P312,987,265.84
Rate of Tax	10%
Tax Due Thereon	P 31,298,726.58
Less: Allowable Tax Credit	22,008,852.71
Tax Due	P 9,289,873.87
Less: Tax Paid	9,187,307.44
Deficiency Tax	P 102,566.43
Add: 25% Surcharge	25,641.60
	P 128,208.03
Add: 20% Interest from 4-21-88 to 10-21-90	64,104.00
TOTAL TAX DUE & COLLECTIBLE	P 192,312.03

Having granted the tax exemption of sales made to the AFP Commissary and Exchange Services (AFPCES), the only the discrepancy why an assessment for deficiency sales tax was still issued was due to the erroneous tax billings made by certain suppliers which resulted in the disallowance of tax credits totalling to P128,734.70. Petitioner credited from its sales tax liability the sum of P22,137,587.41 but respondent's examiner allowed only the sum of P22,008,852.71, thus the balance of P128,734.70 was disallowed as a deduction, itemized as follows: (p. 205, BIR record)

Wanter (Philippines) Incorporated - 1987
<u>Schedule: Over/Erroneous Tax billings made by certain suppliers:</u>

SUPPLIERS	COST	TAX BILLED	ALLOWABLE	DISALLOWABLE	REASONS FOR DISALLOWANCE
1. Standard Plastic Corp.	P32,218.00	P1,182.00		P1,182.00	Contractor's Tax Billings
2. Rotaflex Corp. Phils.	2,842.63	568.53	P 284.26	284.27	Ony 1.5% is allowable, being accredited suppliers (General Merchandise)
3. Cheng Ban Yek & Co. Inc.	20,873.79	626.21	313.11	313.11	- do -
4. Peace Pen Enterprises	56,856.45	1,758.45	852.84	905.61	- do -
5. corina Sales	380,429.76	11,669.60	5,706.45	5,963.15	- do -
6. Frontline Linkage, Inc.	7,602,630.70	228,078.92	114,039.46	114,039.46	- do -
7. Agana Circle Ent., Inc.	65,922.78	1,977.02	988.84	988.18	- do -
8. Orlalo Ent.	59,902.54	5,957.46	898.54	5,058.92	- do -
				P128,734.70	

An investigation conducted by the examiner reveals that petitioner was billed by some of its suppliers for contractor's tax which it deducted from the sales tax due for 1987. Respondent alleged that only excise, sales or millers tax paid can be credited against the sales tax pursuant to the provision of Section 166(a) of the Tax Code

Section 166(a) of the Tax Code, as amended by Presidential Decree No. 2006, provides:

> "SEC. 166. *Tax Credit.* - (a) ***Creditable Taxes.*** - Any excise, sales or miller's tax paid under Title IV and Title V of this Code, on domestically manufactured, processed, produced or imported raw materials, part, accessory or other article locally purchased or imported by the manufacturer for conversion into or intended to form part of any finished product for sale shall be credited against the sales tax on the original sale of the finished product, except agricultural products: *Provided, however,* That the amount of sales tax on domestically purchased raw material, part or accessory, is separately indicated in the sales invoice.
>
> In the case of purchase of raw materials, parts and accessories by a manufacturer from a duly registered and accredited dealer, the amount of tax passed on to the dealer as well as the sales tax on subsequent sale, if indicated as separate items in the dealer's sales invoice shall be allowed as credits against the sales tax due on the finished product. Any advance sales tax paid on imported articles shall be allowed as credits against the sales tax due on the original sale of such imported article."

The credit of contractor's tax was not provided therein. Following the accepted principle of statutory construction ***expressio unius est exclusio alterius*** "what is not included is deemed excluded", the same cannot be allowed as a credit from the sales tax.

It will be observed that the reason for the disallowance of P1,182.00 was due to the fact that it was for Contractor's Tax Billings and the rest were disallowed because only 1.5% should be credited by petitioner since these were purchases made from suppliers in a General Merchandise - meaning the tax allowable is only 1.5% on subsequent sales (Section 164 of the 1987 Tax Code).

Petitioner contends that what is essential is that the tax was passed on to it and was separately billed. "Whether the supplier/dealer paid the correct tax, which was passed on to petitioner, or the said taxes were not properly recorded in its books, is no longer the concern of petitioner as long as the sales tax was billed separately as a separate item in the invoice. Thus, as long as the buyer (petitioner herein) is apprised of the exact amount of the tax shifted to it without having to do further computations to determine the amount thereof, then the purpose of the law is achieved. The recourse of the government in case the correct tax was not paid by the supplier/dealer is to go against the supplier/dealer." Petitioner cited the case of **Atlas Fertilizer Corp. v. Commissioner, 66 SCRA 165**, as follows:

> "To repeat the main issue in the case at bar is whether the AFC is entitled under the Tax Code to deduct the purchase cost of the pyrite it used as ingredient in its manufacture of fertilizer for the purpose of computing the sales tax it must pay on its sales of fertilizer. In expounding their respective positions on this issue, the Commissioner of Internal Revenue and the Court of Tax Appeals appear to have been confused by their obsessional preoccupation with the *incidental* matter of whether or not the ACMDC had paid a sales tax on the pyrite

it had sold to the AFC; they failed to take due stock of the organic relationship among the pertinent sections and provisions of the Tax Code involved (already hereinbefore discussed) viz., Sections 186, 186-A and 188(c), as well as a precept quite basic in the field of sales taxes.

Under Section 188(c), if the ACMDC was the lessee, owner or concessionaire of the mineral land from which it removed the pyrite that it had sold to the AFC, then it was exempt from paying any sales tax on its sales of pyrite. Any purchaser - such as the AFC - of pyrite from the ACMDC may deduct the purchase cost of such pyrite under the authority of Section 186-A which provides:

> 'Whenever a tax-free product is utilized in the manufacture or production of any article, in the determination of the value of such finished article, the value of such tax free product shall be deducted,'

"On the other hand, if the ACMDC was not qualified for exemption from sales tax on its sales of pyrite under Section 188(c) (because it was not the lessee, owner or concessionaire of the mineral land from which it removed the pyrite), then the AFC (or any other purchaser of pyrite from the former) cannot invoke Section 186-A as the legal authority for deducting the total cost of the pyrite it purchased from the ACMDC. However, it does not thereby follow that the AFC (a purchaser of pyrite from the ACMDC) is barred from deducting the purchase cost of the pyrite from the gross selling price of the manufactured article (fertilizer) sold by it. The deduction can still be made, but under the authority of Section 186 which pertinently reads:

> 'x x x *Provided*, That where the articles subject to tax under this section are manufactured out of materials likewise subject to tax under this section and section one hundred and eighty-nine,

> the total cost of such materials, as duly established, shall be deductible from the gross selling price or gross value in money of such manufactured articles.'
>
> The inordinate attention paid by the Commissioner of Internal Revenue and the Court of Tax Appeals to the possibility that the ACMDC did not pay any sales tax on its sales of pyrite to the AFC becomes more clearly *inapropos* when it is considered that, fundamentally, the sales tax is an obligation of the seller and not of the buyer. The Commissioner's recourse is against the ACMDC, and not against the AFC, if the former did not pay any sales tax on its sales of pyrite to the AFC, assuming that the ACMDC was not exempt under Section 188(c) of the Tax Code from payment of sales tax on its sales of pyrite."

With respect to the disallowance of P1,182.00 representing Contractor's Tax Billings, the respondent was correct in citing the provision of Section 166(a) of the Tax Code in that only excise, sales or miller's taxes paid can be credited from the sales tax on the original sales of finished product. This is bolstered by the fact that the sales tax, excise or miller's taxes are paid on "domestically manufactured, processesd, produced or imported raw materials, part, accessory or other article locally purchased or imported by the manufacturer". The Contractor's tax is a tax paid for the sale of services by those persons enumerated in Section 170 of the Tax Code. This does not cover persons subject to the occupation tax who renders service in connection with the practice of their professions. The contractor's tax not being included in the enumeration is therefore excluded.

However, with regard to the rest of the disallowance in the sum of P127,552.70 (P128,734.70 - P1,182.00) the same should be allowed as a valid deduction from the sales tax for the reasons propounded by petitioner. The reliance of petitioner in the cited case above-mentioned is well taken. The sales tax is an obligation alone of the seller, not the purchaser, even if in the commercial world it is a usual practice among vendors to shift all or part of the tax burden to their customers. **(See Abad v. Court of Tax Appeals, L-20834, L-20903, October 19, 1966, 18 SCRA 374, 385; Commissioner of Internal Revenue v. American Rubber Co., Inc., L-19667, November 29, 1966, 18 SCRA 853; Philippine Acetylene Co., Inc. v. Commissioner of Internal Revenue, L-19707, August 17, 1967, 20 SCRA 1056; Gil Hermanis v. Hord, 10 Phil. 218.)** The sales tax being based on gross and not on the selling price includes the cost of manufacture and overhead expenses of the taxpayer since these are cost items which a taxpayer takes into account in determining the selling price of his goods. **(American Rubber Co. v. Collector of Internal Revenue, 64 SCRA 569.)**

For sales tax purposes, the only condition in order to be able to deduct the amount of sales tax on domestically purchased raw material, part or accessory, is that the same must be separately indicated in the sales invoice. Whether or not the seller has correctly imposed the sales tax is of no consequence to the buyer. The fact remains that the burden was shifted to the purchaser. Even if the seller of the goods are general merchandising companies, like those enumerated by the revenue examiner in his worksheet, who according to respondent should have collected only 1.5% sales tax on subsequent sale, the fact still remains that the sales tax passed on to the purchaser-petitioner ranges from 3% to 10%. Section 166(a) allows the sales tax on domestically purchased raw material, part or accessory to be credited against the sales tax on the finished product. As long as the sales tax was passed and paid by the buyer-manufacturer and provided that the sales tax was separately indicated in the sales invoice the same can be deducted by the buyer from his sales tax liability. Therefore, we see no legal and valid reason why the deficiency sales tax assessement for 1987 still stand.

To recapitulate, petitioner is liable to pay only the Deficiency Income Tax for 1987 in the amount of P1,474,437.60, inclusive of surcharge, per Our computation, to wit:

1987 - Deficiency Income Tax

Net Income per Return	P34,872,032.00
Add: Taxes & Duties - Capital Expenditures	3,510,564.00
Net Taxable Income	P38,382,596.00
Tax Due Thereon (35%)	P13,433,909.00
Tax Paid	12,205,211.00
Deficiency Income Tax	P 1,228,698.00
Add: 20% Surcharge	245,739.60 *
Total Per Court's Computation	P 1,474,437.60

(* as corrected)

WHEREFORE, the decision of respondent Commissioner of Internal Revenue dated November 26, 1991 is hereby **modified**.

ACCORDINGLY, petitioner is hereby ordered to pay in favor of respondent the amount of P1,474,437.60, as deficiency income tax for the year 1987, inclusive of 20% surcharge, plus 20% interest per annum from the date prescribed for payment until fully paid pursuant to Section 283(a) of the Tax Code. The compromise penalty imposed by respondent in her deficiency income tax assessment in the amount of P15,000.00 cannot be imposed as it does not appear that petitioner agreed to its imposition. The rule is compromise penalty cannot be imposed or collected without the agreement and conformity of the taxpayer. **(Wonder Mechanical Engineering Corporation v. Coult of TaxAppeals, L-22805 & 27858, June 30, 1975, 64 SCRA 555.)** The Deficiency Sales Tax Assessment for 1987 in the amount of P192,312.03, inclusive of surcharge is hereby cancelled and set aside.

Costs against petitioner.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

MANUEL K. GRUBA
Associate Judge

CERTIFICATION

This is to certify that the above 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