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ATLAS FERTILIZER CORPORATION
Petitioner,

versus

March 15, 1967

CTA CASE NO. 1521

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

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

D E C I S I O N

Petitioner filed this action against respondent for refund or tax credit of ₱90,981.40 as alleged overpaid sales tax in the manufacture and sale of fertilizer. The said amount was reduced to ₱77,310.56 after rectification due to arithmetical error.

The facts of the case, as found by respondent's examiner and adopted by petitioner, show:

> Facts of the Case.--Atlas Fertilizer Corporation, hereinafter called the AFC for brevity, is a domestic corporation formed in accordance with the Corporation Law in May 1957, to engage in the business of manufacturing fertilizer. It started actual operations as such in 1958. Previous to its incorporation; however, it was known as the fertilizer department of the Atlas Consolidated Mining & Development Corporation, hereinafter referred to as ACMDC. ACMDC was granted tax exemption privileges under R.A. 901 to engage in the business of fertilizer manufacturer, a new and necessary industry. This exemption privilege was transferred to AFC with the knowledge and approval of the Department of Finance. AFC enjoyed this privilege until December 31, 1962.

In that last year, January 1-December 31, 1962, however, AFC enjoyed only 10% exemption. (Testimony of its Vice President, Mr. Cayetano C. Pineda and Annual Reports to stockholders; Annexes "BBB", "CCC" & "DDD".)

From the start of its operations in May, 1958, AFC had been using pyrites locally purchased as an ingredient in its manufacture of fertilizer. Though pyrites is subject to tax under the Tax Code, somehow AFC failed to deduct the cost thereof from the gross selling price of the manufactured fertilizer for purposes of computing the 7% sales tax on the latter. (Monthly statements of computation of sales tax, 1958-1962.) It was only in May, 1964, upon advice of its counsel, that AFC started deducting cost of locally purchased pyrites from the gross selling price of the fertilizer it manufactured and sold in computing the 7% sales tax on the finished product.

Due to the statute of limitations provided in Sec. 309, Tax Code, the claim covers only the tax payments made from June 20, 1962 to April, 1964 or within two years from June 18, 1964, the date of the claim for tax credit.

During the period May 1962 to March 1964, AFC purchased from ACMDC some 53,702.28 short tons of pyrites at a cost of ₱1,244,380.57, inclusive of the tax incidental to the purchase. This supply was in addition to existing inventory. A summary of the purchase invoices issued is attached as Annex "XX". ACMDC is a corporation not exempt from the sales tax or any other taxes during the period covered by the claim. From stock cards showing the day to day additions (debit) and withdrawals (credit) to the inventory labelled pyrite, the undersigned is satisfied that all the pyrites purchased as above-stated were used in the manufacture of fertilizer.

In computing its sales tax liability, AFC prepared monthly statements in quadruplicate. The original was filed with the BIR collecting officer and the rest were kept in AFC files.

The monthly statements show how the tax liability of AFC was computed and how the same had been paid. It is on their correctness therefore that the claim of AFC must rest or fall.

On this premise, the undersigned examiner thoroughly verified and investigated the figures shown on each monthly statement and tested the method of computation used. Thus, he verified and examined ANNEX "A", the monthly statement for May 1962, filed by the Cebu City Office of AFC, which is representative of the statements of computation submitted to the BIR. Based on Annex "A", he found:

I. Raw materials used -

These raw materials consisted of imported raw materials and locally purchased raw materials. The latter refer only to pyrites purchased from ACMDC. The imported raw materials are supported by import entry declarations properly authenticated by the proper official of the Bureau of Customs.

From the stockcards and other records maintained by AFC and made available to the undersigned, he is satisfied that these imported raw materials had all been actually used in the manufacture of fertilizer. The pyrites locally purchased are based on purchase invoices sent to AFC by the supplier, ACMDC. As already stated, the undersigned is also satisfied that all the pyrites were used in the manufacture of fertilizer.

II. Cost of production -

This item consists of raw materials mentioned in I, direct labor and others. Cost of direct labor refers to laborers and personnel working in the fertilizer plant itself and is based on the payrolls during the period. "Others" refers to indirect manufacturing expenses, supplies that do not enter the finished product as an ingredient, office maintenance and salaries, depreciation and sundries. The figures are supported by purchase invoices of supplies, payrolls for the indirect labor, suppliers' invoices and book entries. The undersigned went over all these source materials thoroughly and he found them to be correct and accurate.

III. Sales -

This refers to sales made to ACCFA under R.A. 1609 and to commercial sales. The sales to ACCFA are not subject to the sales tax and were not considered in computing the tax liability under review. The commercial sales are subject to the sales tax and the AFC tax liability shown in the monthly statements is based thereon.

The figures showing commercial sales are based on sales invoices. A typical sales invoice of AFC shows the invoice number and date, the name of the product sold by bag, the number of bags sold, the formulation or formula of the product in that bag, delivery receipt number, unit sales price and total sales price, total quantity sold, and of course, the name and address of the customer. In some instances, the discount granted is also shown.

IV. Cost of sales -

These figures show the cost of production of the quantity of fertilizer sold during the month. Theoretically, if the quantity produced in any given month is all sold in that month, then the figures shown in the item "Cost of Production" will tally with that under "Cost of Sales". Such is not the case in reality, however. The fertilizer production in any given month is not sold entirely in that month. It may take so many months to sell the same. Sometimes, the production in a given month might not be enough to meet the demand for that month so that the deficiency has to be satisfied from the production in other months.

AFC has therefore devised a method, which, over the long pull, fully accounts for the cost of production shown in item II above. Since the cost of production in any given month is known together with the bag quantity produced, the average cost per bag can be determined. This cost per bag multiplied by the total number of bags sold during the given month gives the total cost of sales shown in the monthly statement of computation.

V. Cost of raw materials on goods sold -

This shows the cost of the raw materials that went into the production of the fertilizer sold during the month. Instead of deducting this figure 100% from the gross selling price, AFC deducted only the cost pertaining to imported materials. This is shown in the item identified in the statement as "Cost of Imported Raw Materials". Since counsel of AFC believes that the entire cost of the raw materials used, including those purchased locally, should be deducted, AFC is now accordingly recomputing its tax liability per month to support its claim for tax credit of the excess payments.

The undersigned made his own independent recomputation of such excess payments, based on the provision of Sec. 186, Tax Code that the entire cost of the raw materials used is deductible from the gross selling price for purposes of the 7% sales tax on the fertilizer product. Annex "YY" shows the recomputation made by the undersigned, and Annex "ZZ" is a resume of the monthly excess payments totalling ₱77,310.56 from May 1962 through March 1964.

The period covered by the claim for tax credit extended over 23 months and is reported per month to the BIR in the form of the monthly statement of computation of sales tax liability. Since AFC has two offices that made monthly payments, Cebu City and Toledo City, the undersigned verified and examined 46 such monthly statements. The method discussed above for Annex "A" is true for the rest of the statements, and the undersigned is satisfied that each statement reflects accurately the transactions covered by the entries.

The next phase of investigation is the determination of whether or not the amounts shown in each monthly statement as sales tax liability of AFC had been fully paid to the BIR. The best proofs of these payments are of course the official receipts issued by the respective collection agents of the BIR. These were produced either by AFC or the ACA (formerly the ACCFA).

Under R.A. 1609, as amended by R.A. 2706, ACCFA was authorized to purchase on its own fertilizer products and soil conditioners for cheap distribution to bona fide farmers. AFC is one of the suppliers of ACCFA. Under the law, government agencies are required to withhold from the gross selling price due any seller or supplier of the government, corresponding amounts to be applied to the tax liabilities of such seller or purchaser. Despite the fact that AFC sales to ACCFA were exempt under Sec. 6-A, R.A. 2706, ACCFA withheld numerous amounts from the gross selling price due AFC. In turn, ACCFA paid all these withheld amounts to the BIR on behalf of AFC. (Testimony of the Actg. Chief Corporate Accountant and of the Asst. Treasurer and Cashier of ACA, the new name of the old ACCFA.)

The result of the investigation by undersigned into these payments is shown in Annex "Z".

Photostats were made of these original official receipts. The undersigned compared and verified these photostats with the originals and is

> satisfied with their correctness.
> (pp. 2-4, Petitioner's memo., Exh. "WWW", pp. 280-283, BIR records.)

The only question at issue in this case is whether or not the cost of raw material (pyrite) locally purchased by petitioner and used in the manufacture of fertilizer is deductible from the gross selling price thereof before imposing and computing the 7% tax on the sales of fertilizer.

Petitioner's claim for refund or tax credit is predicated on the provisions of Section 186-A of the National Internal Revenue Code which read as follows:

> SEC. 186-A. 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. (Sec. 5, Republic Act No. 2025)

Petitioner contends that Section 186-A of the Revenue Code, _supra_, is plain, unambiguous, clear and sufficiently broad to embrace the deduction of the cost of raw material (pyrite) from the gross selling price of the finished or manufactured product (fertilizer). The exemption of pyrite, a mineral product, from the sales tax is sanctioned by Section 188(c) of the Revenue Code which provides as follows:

> SEC. 188. _Transactions and persons not subject to percentage tax._— In computing the tax imposed in sections one hundred eighty-four, one hundred eighty-five, and one hundred eighty-six, transactions in the following commodities shall be excluded:
>
> x x x x

> (c) Minerals and mineral products when sold, bartered, or exchanged by the lessee, concessionaire, or owner of the mineral land from which removed.

Petitioner argues that, inasmuch as pyrite is a tax-free product which was utilized in the manufacture of fertilizer, the cost of the said raw material should be deducted from the gross selling price of fertilizer before imposing and computing the 7% sales tax, in line with the provisions of Section 186-A of the Revenue Code, _supra_. Respondent, however, contends that pyrite is not a tax-free product because the said mineral or mineral product, which was purchased by petitioner from Atlas Consolidated Mining & Development Corporation, had been subject to the mining tax, whether royalty or _ad valorem_, imposed by Sections 242 and 243 of the Revenue Code. Accordingly, respondent argues that pyrite is not a tax-free product within the purview of Section 186-A of the Tax Code.

Respondent contends further that petitioner is not entitled to deduct the cost of raw material (pyrite) from the gross selling price of the finished product (fertilizer) because Section 186 of the Revenue Code provides, among others, as follows:

> SEC. 186. _Percentage tax on sales of other articles._— 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.

Under Section 186 of the Revenue Code, supra, in order that the cost of raw material may be deducted from the gross selling price of the manufactured product before imposing and computing the tax, it is indispensable that the said raw material must first be subject to the 7% sales tax under the same section of the Tax Code or to the 2% tax imposed by Section 189 of the same Code. Respondent argues, therefore, that inasmuch as pyrite is neither subject to tax under Section 186 nor 189 of the Tax Code but to the royalty or ad valorem tax imposed by Sections 242 and 243 of the said Code, the cost of said material is not deductible from the gross selling price of the manufactured fertilizer.

The legal position and stand taken and adopted by respondent are reflected and manifested in General Circular No. V-252 of the Bureau of Internal Revenue, dated July 15, 1957, which implemented Section 186-A of the National Internal Revenue Code, supra. The said circular specifically provides that the "tax-free product" mentioned in Section

186-A of the Tax Code has reference to raw material purchased from tax-exempt industries established under Republic Act No. 901 because, before the addition of Section 186-A to Section 186 of the Revenue Code, the cost of raw material purchased from tax-exempt industries is not, for purposes of the sales tax, deductible from the gross selling price of the finished product before imposing and computing the 7% sales tax.

The stand taken by respondent was assailed by petitioner on the ground that General Circular No. V-252 of the Bureau of Internal Revenue, implementing Section 186-A of the Tax Code, is null and void because it limits the meaning and scope of the term "tax-free product" found in the said section of the Revenue Code. Respondent countered by alleging that petitioner's claim for refund or tax credit is without any justifiable legal basis.

We are in accord with the stand taken by respondent. In the case of Republic Flour Mills, Inc. vs. Commissioner of Internal Revenue, C.T.A. Case No. 1151, December 15, 1965, involving a similar question at issue, this Court in sustaining respondent's view ruled as follows:

> We do not subscribe to petitioner's view that tax exemption is equivalent to a tax payment. The Supreme Court, in the case of Tan Chin vs. Commissioner, L-15008, January 28, 1961, denied the deductibility of the cost of cotton knitted materials (raw materials) used in the manufacture

of undershirts (finished articles) from the gross selling price of the finished articles because no sales tax was paid on the raw materials which were bought from a tax-exempt industry. (See also Pacific Oxygen & Acetylene Co. v. Comm., L-17708, April 30, 1965.) The fact, therefore, that the raw materials were tax-exempt does not mean payment of the tax so as to preclude its taxability. A clear indication that exemption of raw materials from the payment of tax is not considered payment therefor is the incorporation of Section 186-A, which expressly allows the deduction of the value of tax-exempt raw materials from the gross selling price of the finished articles.

We now come to the question of whether or not petitioner comes within the purview of Section 186-A of the Revenue Code, which provides as follows:

> "SEC. 186-A. Whenever a <u>tax-free product</u> 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." (Underlining supplied)

Congress passed laws (Republic Acts Nos. 35 and 901) exempting new and necessary industries from the payment of taxes. However, Section 186 of the Revenue Code does not allow the deduction of the cost of raw materials bought from new and necessary industries from that of the finished articles if the sales tax on the raw materials has not been previously paid (Tan Chiu vs. Commissioner, <u>supra</u>). Thus, Section 186-A was added to the Revenue Code to allow the deduction of the cost of raw materials bought from new and necessary industries which were utilized in the manufacture of another article.

And since petitioner imported the wheat grain in question, it cannot justify the deduction of its cost from the value of the flour on the provisions of Section 186-A of the Revenue Code. The "tax-free product" mentioned in the said Section 186-A refers to a product or raw material bought from tax-exempt new and necessary industries. Moreover, to sustain the view of petitioner would extend the full tax exemption on the flour beyond December 31, 1958, contrary to the time limit set forth in the certificate of exemption granted to petitioner.

The Bureau of Internal Revenue in implementing Section 5, Republic Act No. 2025 (now Sec. 186-A, Revenue Code), issued General Circular No. V-251 dated July 15, 1957 (Phil. Tax Journal, Vol. 2, p. 605) which reads:

> "Deductibility of cost of tax-exempt raw materials from the gross selling price of manufactured articles. - Section 186-A is a new section. The 'tax-free product' mentioned in this new section has reference to raw materials purchased from tax-exempt industries. Before its enactment, the cost of raw materials purchased from tax-exempt industries is not, for purposes of the sales tax, deductible from the gross selling price of the articles manufactured therefrom. By virtue of its enactment, the cost of said raw materials is now deductible.
>
> "In applying the provisions of this new section, the cost of raw materials purchased from tax-exempt industries prior to June 22, 1957 shall not be allowed as a deduction although they are or may be used after said date. In other words, only the cost of such raw materials purchased on or after June 22,

1957 shall be deductible."

> We do not think that the abovementioned circular is contrary to Section 186-A of the Revenue Code, as contended by petitioner. The construction of a statute placed by the department whose duty it is to carry it into execution is entitled to great weight (Regalado v. Yulo, 61 Phil. 173). And it is a cardinal rule in taxation that "exemptions from taxation are highly disfavored in law, and he who claims exemption must be able to justify his claim by the clearest grant of organic or statute law. An exemption from the common burden cannot be permitted to exist upon vague implications" (Coll. v. Manila Jockey Club, L-8755, March 23, 1956; House v. Posadas, 53 Phil. 338; Asiatic Petroleum v. Llanes, 49 Phil. 466). Petitioner failed to justify its claim for tax exemption and, therefore, the cost of tax-exempt surplus wheat grain imported in the year 1958 but utilized in 1959 cannot be deducted from its gross selling price in 1959.

This case is similar to the case of Republic Flour Mills, Inc., supra, in the sense that in both cases the raw materials used in the manufactured product were not subject to the 7% sales tax under Section 186 of the Tax Code or to the 2% tax imposed by Section 189 of the same Code as a condition precedent to the deductibility of the cost of raw materials from the gross selling price of the finished product before imposing and computing the 7% sales tax.

At first blush it would seem that the doctrine laid down by this Court in the case of Republic

Flour Mills, Inc. was rejected by the Supreme Court in its decision in the case of ARMANDO L. ABAD, doing business as REPUBLIC ALCOHOL DISTILLERY vs. COURT OF TAX APPEALS and COMMISSIONER OF INTERNAL REVENUE, G. R. Nos. L-20834 & L-20903, October 19, 1966.

In the ABAD case, one of the issues therein is "whether or not the cost of ethyl alcohol purchased from other distilleries and used in the manufacture of completely denatured alcohol is deductible from the gross selling price of said completely denatured alcohol in computing the 7% sales tax imposed by Section 186 of the National Internal Revenue Code."

In resolving the question at issue in the said case, our Supreme Court held, among others, as follows:

> The Tax Court, therefore, correctly held that the sales of said ethyl alcohol to Abad are subject to sales tax under the first part of Section 186, already quoted; wherefore, the cost thereof is deductible from Abad's gross selling price of the completely denatured alcohol made from it, for purposes of computing the 7% sales tax due on the latter.
>
> The same result obtains when it is considered that, under Section 188(a) of the Tax Code, transactions in commodities subject to taxes under Title IV of the Code (specific taxes) are to be excluded in computing the sales tax under Sections 184 to 186. Since the alcohol was purchased by Abad before it was denatured, it

> <u>was then subject to specific tax, and its cost should be deducted from the computation of the sales tax due on the sale of the denatured alcohol</u>. (underscoring supplied)

It will be noted from the above-quoted decision of the Supreme Court that, under Section 188(a) of the National Internal Revenue Code, transactions in commodities subject to specific taxes are to be excluded in computing the sales tax under Sections 184, 185 and 186 of the same Code. In other words, before the 7% sales tax imposed by Section 186 of the Tax Code is computed, the cost of all articles subject to specific taxes should be deducted from the gross selling price or gross value in money of the manufactured article.

Be that as it may, we are constrained to express the view that the <u>obiter dictum</u> in the said case is not applicable to and should be distinguished from the case at bar. In the ABAD case, the Supreme Court expressed the opinion that the value of articles subject to specific taxes under Title IV of the Tax Code, when used as raw materials in the manufacture of the finished product (completely denatured alcohol), should be deducted from the computation of the sales tax due on the sale of the finished product. This conclusion of the high tribunal is predicated on the provisions of Sections 188 and 188(a) of the Tax Code which authorizes the exclusion of all articles subject to specific taxes in computing the sales tax imposed in Sections 184, 185 and 186 of the Tax Code.

However, in the case of pyrite, which is a mineral or a mineral product, Section 188(c) of the Tax Code provides that "minerals and mineral products when sold, bartered, or exchanged by the lessee, concessionaire, or owner of the mineral land from which removed" shall be excluded in computing the sales tax imposed by Sections 184, 185 and 186 of the same Code. It should be noted that, unlike articles subject to specific taxes, pyrite as a mineral product must invariably be sold by the lessee, concessionaire, or owner of the mineral land from which removed before the said article is exempted from the sales tax. The evidence of record, however, failed to show that the article in question was sold by the lessee, concessionaire, or owner of the mineral land from which it was removed. Consequently, the value thereof cannot be excluded or deducted in computing the sales tax imposed by Section 186 of the Tax Code on the sale of the finished product (fertilizer).

Moreover, the finished article (fertilizer) is not a mineral product and the sale of fertilizer by petitioner is not exempt from the sales tax imposed by Section 186 of the Tax Code. Neither can the value of pyrite be deducted from the sale of fertilizer before imposing and computing the sales tax because pyrite, unlike articles subject to specific taxes, is not always exempt from the sales tax unless the conditions imposed by Section 188(c) of the Tax Code are met or satisfied.

WHEREFORE, finding no merit in petitioner's claim for refund or tax credit, the instant petition for review has to be, as it is hereby, dismissed with costs against petitioner.

SO ORDERED.

Quezon City, March 15, 1967.

ESTANISLAO R. ALVAREZ
Associate Judge

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

RAMON L. AVANCEÑA
Associate Judge