REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PROCTER & GAMBLE PHILIPPINE
MANUFACTURING CORPORATION,
Petitioner,

- versus - C.T.A. CASE NO. 2740

THE COMMISSIONER OF INTERNAL
REVENUE,
Respondent.
x - - - - - - - - - - - - - - - - x

D E C I S I O N

This is a petition to review the decision of respondent Commissioner of Internal Revenue holding petitioner Procter & Gamble Philippine Manufacturing Corporation liable for deficiency 7% sales tax on lard, margarine, soap, etc. in the amount of ₱1,032,257.38 and deficiency sales tax (difference between 7% and 2%) on cooking oil for the year 1967 in the amount of ₱263,570.91, or a total of ₱1,295,828.30, inclusive of 25% surcharge for late payment.

Petitioner, Procter & Gamble Philippine Manufacturing Corporation, hereinafter referred to as Procter & Gamble, PMC, for brevity, a domestic corporation organized and existing under Philippine Laws, is engaged among others, in the manufacture of lard, margarine, soap, detergents, palm oil, glycerine, cooking oil and crude coconut oil.

Sometime in February 26, 1968, Revenue Examiner Ruperto Estrada examined the books of account and other accounting records of petitioner for business tax purposes for the year 1967.

After investigation, petitioner received on September 17, 1971 a letter of assessment dated August 19, 1971 demanding against petitioner for 1967 the payment of deficiency 7% sales tax on lard, margarine, soap, etc. in the amount of P1,032,257.38. and deficiency sales tax (difference between 7% and 2%) on cooking oil in the amount of P263,570.91, or a total of P1,295,828.30, inclusive of 25% surcharge for late payment (pp. [illegible], BIR rec.) computed as follows:

7% Sales Tax on Lard, Margarine, Soap, etc.

Amount subject to sales tax per investigation	P48,084,009.21	
7% sales tax due thereon	3,365,880.64	
Less: Tax already paid	2,540,074.73	
Deficiency sales tax due	825,805.91	
Add: 25% surcharge for late payment	P 206,451.47	P1,032,257.38

7% Sales Tax on Cooking Oil:

Amount subject to sales tax per investigation	P 4,184,316.71	
7% sales tax due thereon	P 292,902.16	
Less: Tax already paid	82,045.43	
Deficiency sales tax due	P 210,856.73	
Add: 25% surcharge for late payment	52,714.18	P 263,570.91
TOTAL AMOUNT DUE AND COLLECTIBLE		P1,295,828.29

The assessment for deficiency 7% tax on "lard, margarine, soap, etc." aforesaid arose mainly from the disallowance of the deductions for containers and packaging materials for not allegedly being taxed under then Section 186 of the Tax Code. (Par. 5, Petition for Review; Admitted, Par. 4, Answer.) In other words, the raw materials were not made subject to the 7% sales tax but allegedly to the 3% contractor's tax, the said materials having been produced allegedly by suppliers per specifications of petitioner; while the assessment for deficiency sales tax on cooking oil is due to the contention of respondent that the same was taxable under then Section 186 of the Tax Code at 7% and not under Section 189 at 2%. (Par. 7, Petition for Review; Admitted, Par. 1, Answer.)

On September 28, 1971, petitioner wrote a letter dated September 27, 1971 addressed to the Bureau of Internal Revenue's Business Tax Division and requested for details as to how the assessment was arrived at. (Exh. "BR-3", pp. 122, CTA rec; pp. 8-10, T.S.N., February 20, 1979.) Then on November 25, 1971, petitioner filed its letter of protest. (Exh. "II", pp. 86-100, BIR Rec.)

On August 12, 1975, respondent rendered a decision, which was received by petitioner on September 13, 1975 (Exh. "AA", pp. 169-174, BIR Rec.; Annex "A", Petition for Review) denying the protest. Hence, petitioner filed its petition for review on September 17, 1975. Respondent, filed its answer to the petition for review on March 16, 1976.

Respondent, in its memorandum in chief stated that he is withdrawing the assessment for deficiency sales tax on cooking oil, in view of BIR Ruling No. 203-0000-00-098-83 dated June 8, 1983, providing that proprietors or operators of coconut oil mills are subject to the miller's tax of 2% and not to 7% sales tax assessed against petitioner.

The various issues to be resolved by the Court are as follows:

1. Whether or not this Court has jurisdiction to take cognizance of this case;

2. Whether or not the examiner of respondent overstated the gross sales figure in computing the deficiency assessment on the sales of lard, margarine, soap, etc.;

3. Whether or not the disallowance of the costs of raw materials against the sale of lard, margarine, soap, etc., was proper;

4. Whether or not the sales taxes on the sales of lard, margarine, soap, etc., billed separately on the sales invoices to petitioner's customers should be included as part of the tax base; and

5. Whether or not the twenty-five percent (25%) surcharge for late payment is imposable in this case.

As to the first issue, respondent maintains that this Court has no jurisdiction to entertain the present appeal as the assessment dated August 19, 1971 was only protested on November 25, 1971, after the lapse of more than thirty (30) days from receipt of said assessment on September 17, 1971, and a decision of the Commissioner of Internal Revenue must spring from a seasonably filed protest of an assessment in order to fall within the jurisdiction of this Court.

Petitioner, on the other hand, vehemently contends that this Court has jurisdiction to entertain the present appeal. The assessment dated August 19, 1971 was properly protested or disputed on November 25, 1971. This protest was decided by respondent on August 12, 1975. This decision dated August 12, 1975, received by petitioner on September 13, 1975, became the decision on the disputed assessment which should be appealed to this Court within thirty-days from receipt pursuant to Section 7 and 11 of Republic Act No. 1125, the charter of this Court. The decision of the Commissioner of Internal Revenue having been brought to this Court on appeal on September 17, 1975, or three days from receipt of said decision on the disputed assessment, it was appealed within the period provided by law. (St. Stephen's Association and St. Stephen's Chinese Girl's School vs. The Coll. (Comm.) of Internal Revenue, 104 Phil 314; Comm. vs. Villa etc., 22 SCRA 3; Comm. vs. Gonzales etc., 18 SCRA 757; Ker & Co, Ltd. vs. CTA, etc., 4 SCRA 160; Roman Catholic Archbishop of Cebu vs. Coll., 4 SCRA 279.)

With respect to the second issue, petitioner maintains that respondent had in its investigation overstated the gross sales of petitioner in computing the latter's deficiency sales tax on lard, margarine, soap, etc. bringing about an inherent error in the computation and assessment of the 7% sales tax on lard, margarine, soap etc. A perusal of the BIR and CTA records, as well as the evidence, both testimonial and documentary, discloses the correct position of petitioner. BIR Examiner, Ruperto Estrada, in his memorandum dated March 18, 1970, used the figure ₱110,620, 020.28 (pp. 39-40, BIR Rec.) which comprised the total of the monthly sales for the year 1967 as reflected in the monthly percentage tax return. (Exhs. "A" to "L" pp. 93-104, CTA Rec. & p. 23, BIR Rec. respectively.) However, in a subsequent supplemental memorandum dated January 6, 1971 (pp. 65-66, BIR Rec.), Examiner Estrada had reflected the figure ₱110,680,020.28 indicating a difference of ₱60,000.00 in the sales for 1967. At the hearing of this case before this Court, Examiner Estrada at first insisted that the correct amount of the monthly sales for 1967 was ₱110,680,020.28. (pp. 31-41, T.S.N., April 5, 1977.) On persistent cross examination, where he was shown the percentage tax return of petitioner for October 1967 indicating a gross sales figure of ₱8,211,823.48 while his worksheet figure (p. 59, BIR rec.) showed a different amount of ₱8,271,823.48, resulting in an overstated gross sales of petitioner for 1967, he finally relented by admitting in open court that the amount of ₱8,211,823.48 as shown in the percentage tax return not as reflected in his worksheet (p. 23, BIR rec.), was the correct amount of sales for October, 1967, and explained that what might have been figure "1" in the percentage tax return of petitioner must have copied as "7" in his work sheet, which explains the difference of the overstated gross sale for the year of ₱60,000.00. The records and evidence in this case, as well as Examiner Estrada's admission in the trial, clearly show that the gross sales for the month of October was ₱8,211,823.48, not ₱8,271,823.48, and this error was later reflected in the total gross sales for the year 1967 which ought to be only ₱110,620,020.28, not ₱110,680,020.28 as reflected by respondent's examiner. (p. 40, T.S.N., April 5, 1977.)

Coming to the third issue, petitioner contends that the disallowance by respondent of the deduction of raw materials against sales of lard, margarine, soap, etc. was improper; that it was improper because the truth is that petitioner had acquired the raw materials from suppliers which were subject not to 3% contractors tax but to 7% sales tax.

The final decision of respondent on the disputed assessment states that the reason for the disallowance of the costs of the containers and packaging materials purchased by petitioner against the gross sales of lard, margarine, soap, etc. was that said containers and packaging materials were purchased upon specifications made by petitioner and that only 3% tax was paid thereon. (p. 174, BIR rec.) Obviously, the decision of respondent was based on the examiner's report, with the exception that Examiner Ruperto Estrada <u>never said that only 3% tax was paid thereon.</u> (Underlining ours.) What he said in his report is that he "xxx deducted the raw materials which are believed to be subject to the 3% contractor's tax." (Please see memoranda dated March 18, 1970, & Jan. 6, 1971, pp. 39-40, & pp. 65-66, BIR rec. respectively.) It is to be contrarily noted that the list of suppliers from whom the raw materials were secured and the amounts purchased from them by petitioner shows that actually 7% tax was paid thereon by the suppliers (p. 8, BIR rec.) and not 3% tax.

In his memorandum dated March 18, 1970 (p. 40, *supra*) Examiner Ruperto Estrada gave his reasons for recommending disallowance of the packaging materials purchased by petitioner, thus:

> "x x x. In computing the 7% percentage tax, it deducted raw materials which are believed to be subject to the 3% contractor's tax. The reason is, that the taxpayer bought these raw materials on own specifications such as to quantity, quality, delivery date, unit costs per item; right of rejection of the buyer and such other specifications to suit the requirements of the subject taxpayer. The nature of the relationship between the buyer (P & G PMC) and the vendors is believed to be a contract such that the vendors are subject to the 3% percentage tax on its gross sales instead of the 7% tax; e.g. General Offset Press, one of the vendors. x x x".

In his supplemental and amended memorandum dated January 6, 1971 (p. 66, supra), Examiner Ruperto Estrada commented as follows:

> "x x x. The undersigned reiterates his stand on the disallowance of deducted raw materials as explained in the original memorandum. The counsel cited rulings to dispute the undersigned's stand on this matter. However, it is still believed that such rulings cannot remain irreversible in view of the findings of the undersigned. A sample of the requisition order of the above taxpayer given to its suppliers clearly show the relation between the suppliers and the buyer that of a contract. As admitted by one supplier, they were required to pay the 7% sales tax by the above taxpayer for them to continue buying the containers. This has the effect of enabling the herein taxpayer to deduct said

containers from its gross sales in determining its sales taxes. x x x"

These above statements of Examiner Estrada were basically relied upon by respondent in issuing the assessment, and in denying the protest of petitioner, on this issue of the deductibility of the containers and packaging materials. (pp. 48-50, t.s.n. April 5, 1977.)

As gleaned from Examiner Estrada's report and his testimony, the factual basis for the disallowance is so wanting that indeed the burden of proof to show that it is not liable for the deficiency sales tax has never shifted to petitioner. In other words, the rule that an assessment is presumed prima facie to be correct does not apply in this case. Petitioner is not supposed to possess and for this Court to assume that it possesses clairvoyant powers, and for it to divine, which of the containers and packaging materials it purchased from the suppliers, the examiner presumes to be subject to the 3% tax and for what particular reason; which particular term or condition agreed upon characterized the relationship between buyer and seller as in the nature of a contract, as the examiner meaninglessly and vaguely asserts, so as to subject said raw materials to 3% contractor's tax instead of 7% sales tax; who was or were the suppliers who admitted that they were made to pay 7% tax so that petitioner would continue buying from them.

Nevertheless, petitioner submitted substantial evidence to refute the disallowance of costs of the containers and packaging materials in question. (Exh."N", "N-1", "N-2", "N-3", "O", "O-1", "O-2", "O-3", "P", "P-1", "P-2" & "P-", pp. 105-116, CTA rec.; pp. 10-21, t.s.n. April 5, 1977.) Evidence was introduced by petitioner that Flexo Manufacturing Corporation, one of its suppliers, was in fact a manufacturer as was ruled by the Commissioner of Internal Revenue, and that as testified to by witness Araceli Garcia, in 1967, the year at issue. Flexo had been paying the manufacturer's sales tax which disproved the unsupported allegation of respondent that the suppliers of petitioner paid the 3% contractor's tax only. (Exh. "U", p. 121, CTA rec., Exhs. "CC", "CC-1", "DD", "DD-1", "EE", "EE-1", "FF", "FF-1", "GG", "GG-1", pp. 123-127, CTA rec.; pp. 2-9, t.s.n. Nov. 23, 1983.) Besides in his caption of the list of petitioner's suppliers (p. 8, BIR rec.), thus;

> "Procter & Gamble PMC Purchases of Containers on which the 7% percentage tax was paid and made as deductible materials in the computation of the 7% percentage tax on finished products.
>
> "xxx xxx xxx
>
> xxx xxx xxx
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> xxx
>
> (SGD.) RUPERTO J. ESTRADA
> Rev. Examiner II"

respondent had admitted by his examiner signing it, and being an official document, it is an admission against interest of respondent Commissioner of Internal Revenue, to the effect that the raw materials in question were subject to the 7% sales tax. Respondent Commissioner cannot now renage what his agent, Examiner Estrada, previously officially admitted. The testimonial and documentary evidence presented by petitioner were never refuted, impugned or overthrown by respondent as no evidence whatsoever was presented on this matter by his counsel.

As to the deductibility of these raw materials, the pertinent portion of then Section 186 of the Tax Code, quoted hereunder for realy reference states as follows:

> "Sec. 186. Percentage tax on sales of other articles.-
>
> x x x. Provided, That where the article subject to tax under this section are manufactured out of materials likewise subject to tax under this section and section one hundred eithty-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".

This provision of law sustains the stand of petitioner that the cost of packaging materials and other containers are properly deductible from petitioner's gross sales in computing its sales tax.

In disallowing the amount of ₱2,264,498.60, as deductible costs of raw materials from petitioners gross sales, in computing the sales tax liability, respondent stated that said packaging materials, etc. were made by the suppliers only upon orders and specifications of petitioner, and, that therefore, the relationships is that of a principal and contractor, and which transaction are subject to the 3% tax only, and not that of a buyer and seller subject to the 7% tax. The contention of respondent is not tenable. As long as the suppliers of such raw materials are habitually engaged in the making and sale thereof, such suppliers and/or manufacturers of such raw materials would nevertheless still be manufacturers, regardless of whether previous orders were placed by its customers. Thus, it has been held by the Supreme Court in a case that the fact that customers place their orders according to their specifications does not necessarily alter the nature and character of the establishment as a manufacturer. In other words, the filling up of previous orders according to specifications made, does not alter the nature of said raw materials as items subject to sales tax imposed by Section 186 of the Tax Code. (Celestino Co & Co. v. Collector Internal Revenue, G.R. No. L-8506, Aug. 31, 1956; 99 Phil. 841, 844.)

Even assuming arguendo but without deciding it that only 3% tax was paid by the suppliers as alleged by respondent, there is no valid reason why petitioner should be precluded from deducting the cost of raw materials considering that the suppliers are manufacturers and not contractors; and, that if any error was ever committed, it is an error on the part of the suppliers who should be truly taxed as manufacturers of the raw materials they supplied to petitioner. As such, the suppliers should be made to pay the 7% sales tax, instead of prejudicing an innocent purchaser. Thus, in the case of Abad vs. Court of Tax Appeals, 18 SCRA 374, the Supreme Court, in allowing the deductibility of the cost of ethyl alcohol from the cost of denatured alcohol in computing the sales tax, notwithstanding the fact that ethyl were not subjected to sales tax, stated that the fact that the suppliers of ethyl alcohol did not pay the sales tax thereon is no reason for burdening the manufacturer of the denatured alcohol with the said tax by not allowing said manufacturer to deduct the cost of ethyl alcohol.

In the light of the above, the disallowance of the containers and packaging materials admittedly taxed at 7% is therefore improper and capricious as the same is based on erroneous presumption which lead to an assessment so devoid of relevant facts and substance. The rule that an assessment is presumed correct does not apply here as the burden of proof rule should not be applied to defeat justice. /(Mertens, Law of Federal Income Taxation, Par. 50-65, Vol. 9, (1982 Rev. Vol.)7 Moreover, the correctness of assessment, being a mere presumption, cannot be made to rest on another presumption (Coll. of Int. Rev. vs. Benipayo, 4 SCRA 182) i.e. the presumption of respondent that the raw materials might have been or believed to be subject to 3% tax.

As to the fourth issue, respondent alleges that petitioner in the issuance of invoices to its customers computed the 7% sales tax on the gross selling price without first deducting therefrom the cost of raw materials used in contravention of the decision in the case of Philippine Acetylene Co. vs. Silverio Blaquera, G.R. No. L-13728, Prom. November 30, 1962. (pp. 282-286, CTA Rec.) Petitioner, on the other hand, argues that there is no legal justification for including the amounts billed to its customers as part of the gross selling price, in computing the 7% sales tax under Section 186 of the Tax Code, since the sales invoices issued clearly show or indicate that the amount of sales tax was included in the total amount or price payable by the customer. (pp. 229-235, CTA Rec.) In other words, petitioner maintains that the percentage taxes were billed separately to its customers and computed after first deducting the costs of raw materials used by it in the manufacture of its finished products such as lard, margarine, soap, etc.

The records will show that in recommending the assessment, respondent's Examiner Ruperto Estrada relied on the Philippine Acetylene case, supra, alleging that the taxpayer did not deduct the cost of raw materials before computing the 7% tax and that the assessment of respondent was issued based on the allegation that the sales taxes paid were not separately billed to petitioner's customers. (Connel Bros., Co. Philippine vs. Coll. of Int. Rev., G.C. No. L-15470, December 26, 1963, 9 SCRA 735.) There seems to be a disagreement between the respondent and his examiner as to the actual basis for including the percentage taxes as part of the tax base. However, both grounds to our mind are erroneous. Petitioner maintains otherwise asserting that it computed the 7% tax after it had deducted the costs of raw materials.

We will now discuss separately the grounds advanced by respondent and his examiner. With respect to the ground advanced by respondent's letter of denial subject of this appeal, witness Araceli Garcia testified to the effect that since 1962, petitioner corporation had been billing the tax separately to its customers (pp. 4, 7, t.s.n. April 5, 1977) and that since that time on there was no other examiner who had raised this question. At the hearing of October 6, 1978 (p. 45, CTA rec.), witness presented sample sales invoices for the year in question and official receipts evidencing payments made by customers. A perusal of Exhs. "Q", "R", and "S" (pp. 117-119, CTA Rec.), said invoices will indicate that there are three columns therein, namely, "Unit price sales tax incl.", "Amount Sales Tax included" and "Sales tax". Under the second money column of Exh. "Q", appears the product of quantity multiplied by unit price for each item, e.g., "Tide 60". etc. For each item, the sales tax is recorded under the third money column. Thus, for the second item, "Tide 288" shows a unit price of "P24.95", the amount sales tax included of "P623.35", and sales tax of "P22.44" under the column "sales tax". The customer is appraised of the unit price and total amount of each item, and tax on such amount but at the end of the invoice the following information appears:

	Unit Price Sales Tax Included	Amount Sales Tax Included	Sales Tax
End of Invoice Gross		₱2,559.50	₱ 53.58
2% discount		51.19	
Net		₱2,508.31	

From the information gathered from the invoices, the customer is appraised of the details by item and by totals. The customer is apprised too of the sales tax being shifted to them. This manner of separate billing the sales tax is in accord with the Connel Bros. case, *supra*.

As to the ground asserted by Examiner Estrada, we could see that he relied on bare allegation without any factual support, as he has not submitted any sample invoice showing that petitioner billed to its customers the 7% tax before deducting the raw materials. Neither did he reiterate at the hearing his grounds which appears only in his second memorandum; he merely relied on the Philippine Acetylene case and alleges that the tax was computed before deductions for raw materials. Moreover, his ground was repudiated by respondent who asserted another ground in his letter-decision denying petitioner's protest. Nonetheles, petitioner had strong oral and documentary evidence which were never impeached, countered or rebutted by respondent. Both grounds relied upon and asserted by the respondent is based on erroneous presumptions and without any factual basis to lean on.

While it is true and well settled is the rule that an assessment is presumed to be correct, and that the petitioner has the burden of proof to show that the same is invalid, we find the assessment in this case totally wanting in relevant facts and substance to stand on. Examiner Estrada only presumed petitioner had deducted raw materials which were subject to 3% tax, instead of 7% sales tax; he also presumed that petitioner issued invoices to customers and computing the 7% tax on the gross selling price without first deducting the cost of raw materials used in the manufacture of the finished article. Consequently, we feel that the burden of proof to overturn the assessment never shifted to petitioner. It has been clearly judicially stated that assessment should not be based on mere presumptions no matter how reasonable or logical said presumptions maybe (Collector of Internal Revenue vs. Benipayo, 4 SCRA 182) and the burden of proof rule is not to be applied, as in this case, which will have the effect of defeating justice. (Mertens, The Law of Federal Income Taxation, Par. 50.65, Vol. 9, p.187.)

In view of the above findings, we will refrain from discussing the fifth issue, it having become moot and academic.

WHEREFORE, the decision appealed from should be, as it is hereby, REVERSED.

No pronouncement as to costs.

SO ORDERED.

Quezon City, September 30, 1985.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

ALEX Z. REYES
Associate Judge