REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PHILIPPINE PIPES
& MERCHANDISING
CORPORATION,
Petitioner,

versus

CTA CASE NO. 1858

march 30/70

COMMISSIONER OF
INTERNAL REVENUE,
Respondent.

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DECISION

This is an appeal from a decision of respondent dated March 10, 1967 assessing petitioner in the sum of ₱11,800.91 as fixed and deficiency sales taxes and surcharges under Sections 182, 186 and 194 of the Tax Code for the years 1958, 1959 and 1960, plus ₱2,360.00 as compromise penalty or a total of ₱14,160.91.

Petitioner is a domestic corporation engaged in the business of manufacturing and selling concrete pipes and hollow blocks at its factory in Meycauayan, Bulacan. After examination and investigation of the business of petitioner, respondent sent a letter of assessment and demand dated January 28, 1964 for the payment of the sums of ₱5,507.45, ₱4,586.68 and ₱1,786.78 or a total of

₱11,800.91 as fixed and deficiency sales taxes and surcharges for the years 1958, 1959 and 1960, computed as follows:

1958

Gross Sales	₱70,642.56
Less: Deductible Raw Materials	998.75
Taxable Sales	₱69,643.81
7% sales tax thereon	₱ 4,875.07
Less: Taxes already paid	469.11
Deficiency sales tax	₱ 4,405.96
25% surcharge thereon	1,101.49
Total Amount Due	₱ 5,507.45

1959

Gross Sales	₱86,551.93
Less: Deductible Raw Materials	24,728.59
Taxable Sales	₱61,823.34
7% Sales tax thereon	₱ 4,327.63
Less: Taxes already paid	674.29
Deficiency sales tax	₱ 3,653.34
25% surcharge thereon	913.34
Amount Due	₱ 4,566.68
Add: C-13 Fixed tax deficiency	20.00
Total Amount Due	₱ 4,586.68

1960

Gross Sales	₱43,164.87
Less: Deductible Raw Materials	14,129.73
Taxable Sales	₱29,035.14
7% sales tax thereon	₱ 2,032.46
Less: Taxes already paid	587.04
Deficiency sales tax	₱ 1,445.42
25% surcharge thereon	361.36
Amount Due	₱ 1,806.78
Less: C-4 fixed tax	20.00
Total Amount Due	₱ 1,786.78

In addition thereto, petitioner was requested to pay the sum of ₱2,360.00 as compromise penalty. This assessment and demand was protested by petitioner in its letters dated November 30, 1964 and February 17, 1966 claiming that it is not a manufacturer of concrete pipes and hollow blocks but only a government contractor and as such subject only to the 3% contractor's tax under Section 191 of the Tax Code.

The above-mentioned requests for reconsideration of petitioner was denied by respondent in a letter dated April 25, 1966 from which petitioner, on June 15, 1966, again requested a reconsideration and reinvestigation.

Subsequently, on June 18, 1966, respondent requested petitioner to submit evidence that it was a contractor and not a manufacturer as claimed by it. Petitioner complied with this request.

Not satisfied with the evidence submitted by petitioner, respondent on March 10, 1967 reiterated his assessment and demand. Thereafter, petitioner filed the instant petition for review on June 5, 1967.

As adverted to above, this petition refers to deficiency sales taxes for the years 1958, 1959 and 1960.

The issues to be resolved in this case are the following:

1958

1. Whether or not the right of respondent to issue the deficiency sales tax assessment for 1958 had prescribed;

2. If such right had not prescribed, whether or not the sum of ₱40,887.42 as cost of all raw materials used to manufacture concrete products, including that of cement, was deductible for purposes of computing the 7% sales tax.

1959 and 1960

1. Whether petitioner was taxable as a contractor or a manufacturer under the Tax Code;

2. In the alternative that petitioner was a manufacturer, whether or not the cost of cement as raw material in the manufacture of concrete products was also deductible for purposes of computing the 7% sales tax;

3. Whether or not the imposition of the compromise penalty is legal.

We will first consider the assessment for 1958.

Petitioner admits that for the year 1958, it was a manufacturer of concrete products but urges that respondent's assessment was made beyond the

the five-year period prescribed by Section 331 of the Tax Code. Petitioner claims that the date for filing the sales tax return for the last month of 1958 was on January 20, 1959 and that it had filed the return and paid the corresponding tax for the same on January 19, 1959. The assessment by respondent was made on January 28, 1964 and, therefore, the same was made beyond the five-year prescriptive period.

Perusing the records of the instant case, we find Exhibits J, J-1 to J-8, which are letters purporting to be monthly sales tax returns for the year 1958. The last letter, Exhibit J-8, is a return dated January 19, 1959 for the sales of December 1958, which was due on January 20, 1959. These documents were admitted without objection by respondent's counsel. Thus, on the basis of the evidence on record the right of respondent to issue a deficiency sales tax assessment prescribed on January 21, 1964, and the assessment of January 28, 1964 was out of time, having been made beyond the prescriptive period of five years. Indeed, even respondent's Memorandum does not contest petitioner's defense of prescription.

With this finding, it becomes of course unnecessary for us to dwell on the other issues raised by the parties with respect to the sales taxes for 1958.

Now, we come to the assessment for 1959 and 1960.

The first issue raised by the parties is whether petitioner is taxable as a manufacturer under Section 186 of the Revenue Code or as a contractor under Section 191 of the same Code.

We have read quite thoroughly Section 191 of the Revenue Code providing for a percentage tax on contractors noting each of the numerous occupations enumerated therein and we cannot find one under which petitioner can properly fall. For the instant case we can very aptly borrow the following language in Celestino Co & Co. v. Collector of Internal Revenue (99 Phil. 841), for it is squarely in point:

> "Even if we were to believe petitioner's claim that it does not manufacture ready-made sash, doors and windows for the public and that it makes these articles only upon special order of its customers, that does not make it a contractor within the purview of section 191 of the National Internal Revenue Code. There are no less than fifty occupations enumerated in the aforesaid section of the National Internal Revenue Code subject to percentage tax and after reading carefully each and every one of them, we cannot find one under which the business enterprise of petitioner could appro-

priately fall. It would require a stretch of the law and much effort to make the business of manufacturing sash, doors and windows upon special order of customers fall under the category of 'road, building, navigation, artesian well, water works and other construction work contractors; filling contractors' as enumerated in the section being invoked by petitioner's counsel. Construction work contractors are those who alter or repair buildings, structures, streets, highways, sewers, street railways, railroads, logging roads, electric, steam or water plants telegraph and telephone plants and lines, electric lines or power lines, and includes any other work for the construction, altering or repairing for which machinery driven by mechanical power is used. (Payton vs. City of Anadardo 64 P. 2d 878, 880, 179 Okl. 68).

One of the main purposes of the petitioner is stated in its articles of incorporation as follows:

"(a) To manufacture, buy, sell, import and export, and generally deal in water pipes of every nature and description together with their accessories;" (Exh. H, p. 2, Vol. III, Petitioner's Folder of Exhibits.)

Manufacturing is thus one of the purposes of petitioner. And in petitioner's Reply Memorandum, it admits that it manufactured the concrete pipes and hollow blocks ordered by the government. Indeed, the making of concrete pipes and hollow blocks is a manufacturing process under Section 192(x) of the Revenue Code. However, petitioner still insists that since: (1) it sold its cement pipes and hollow blocks only to the government and not to the general public; (2) and the purchases by various government agencies and offices were made only upon previous public bidding; and (3) the concrete products made by petitioner fulfilled particular specifications different from those generally sold in the market for public consumption, it should be held taxable as a contractor rather than as a manufacturer. To answer these pretensions we can do no better than quote the following portion of the decision in the Celestino Co case cited above:

> There was a strong dissent; but upon careful consideration of the whole matter we are inclined to accept the above statement of the facts and the law. The important thing to remember is that Celestino Co & Company habitually makes sash, windows and doors, as it has represented in its stationery and advertisements to the public. That it "manufactures" the same is practically admitted by appellant itself. The fact that windows and doors are made by it only when customers place their orders, does not alter the nature of the establishment, for it is obvious that it only accepted such orders as called for the employment of such materials-moulding, frames, panels-as it ordinarily manufactured or was in a position habitually to manufacture.

Perhaps the following paragraph represents in brief the appellant's position in this Court:

> "Since the petitioner, by clear proof of facts not disputed by the respondent, manufactures sash, windows and doors only for special customers and upon their special orders and in accordance with the desired specifications of the persons ordering the same and not for the general market: since the doors ordered by Don Toribio Teodoro & Sons, Inc., for instance, are not in existence and which never would have existed but for the order of the party desiring it; and since petitioner's contractual relation with his customers is that of a contract for a piece of work or since petitioner is engaged in the sale of services, it follows that the petitioner should be taxed under section 191 of the Tax Code and NOT under section 185 of the same Code." (Appellant's brief, p. 11-12).

But the argument rests on a false foundation. Any builder or homeowner, with sufficient money, may order windows or doors of the kind manufactured by this appellant. Therefore it is not true that it serves special customers only or confines its services to them alone. And anyone who sees, and likes, the doors ordered by Don Toribio Teodoro & Sons Inc. may purchase from appellant doors of the same kind, provided he pays the price. Surely, the appellant will not refuse, for it can easily duplicate or even mass-produce the same doors—it is mechanically equipped to do so.

<u>That the doors and windows must meet desired specifications is neither here nor there. If these specifications do not happen to be of the kind habitually manufactured by appellant—special forms of sash, mouldings or panels—it would not accept the order—and no sale is made. If they do, the transaction would be no different from a purchasers of manufactured goods held in stock for sale; they are bought because they meet the specifications desired by the purchaser.</u>

Nobody will say that when a sawmill cuts lumber in accordance with the peculiar specifications of a customer—sizes not previously held in stock for sale to the public—it thereby becomes an employee or servant of the customer,[1] not the seller of lumber. The same consideration applies to this sash manufacturer.

The Oriental Sash Factory does nothing more than sell the goods that it mass-produces or habitually makes; sash, panels, mouldings, frames, cutting them to such sizes and combining them in such forms as its customers may desire. (pp. 843-845.)

As may be gathered from the foregoing quotation the important thing is that petitioner habitually makes concrete pipes and hollow blocks. As adverted to above, petitioner was organized for, among other things, the manufacturing of pipes and concrete blocks. It admits to have had not only

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[1]With all the consequences in Article 1729 New Civil Code and Act No. 3959 (bond of contractor).

one but different transactions with the government for the manufacture of concrete pipes and hollow blocks, transactions which were made with different entities of the government at different times; all of these show habituality. Although it claims not to have sold to the general public because its facilities were geared for the ordinary specification of the government, it is still natural to assume that had parties ordered from them concrete pipes and hollow blocks with the same specifications as the government for the same price, it would not have refused to undertake the job for them if the price is adequate, considering that petitioner was in business for profit. Needless to say petitioner is a manufacturer, not a contractor.

In the light of the Supreme Court decision in Cebu Portland Cement Co. v. Commissioner of Internal Revenue, G.R. Nos. L-18649, Feb. 27, 1965 and L-22605, January 17, 1965, both petitioner and respondent are agreed that cement is a manufactured product, hence subject to the 7% sales tax. Petitioner now asserts that the cost of cement as raw material used in the manufacture of concrete product should first be deducted from the gross sales of concrete products for the purpose of computing the 7% sales tax on said concrete products in accordance with Section 186 which provides:

> ". . . 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 of gross value in money of such manufactured articles." (Underscoring supplied.)

On the other hand, while respondent admits that cement is now considered to be a manufactured product in the light of the doctrine in the aforesaid Cebu Portland Cement case and is thus subject to the 7% sales tax under Section 186 of the Tax Code, respondent insists that cement used in the manufacture of concrete products for the years 1959 and 1960 in question should not be deducted from the gross sales of concrete products inasmuch as during the period involved therein cement was not taxed as a manufactured product subject to sales tax, but only as a mineral product subject to ad valorem tax.

We find petitioner's position to be meritorious. As adverted to further above cement qua cement is a manufactured product. Said the Supreme Court in Cebu Portland Cement Co. v. Comm. of

Int. Rev., *supra* -

> This line of argument suffers from two infirmities: First, while cement is composed of 80% minerals, it is not merely an admixture or blending of raw materials, as lime, silica, shale and others. It is the result of a definite process - the crushing of minerals, grinding, mixing, calcining, cooling, adding of retarder or raw gypsum. In short, before cement reaches its saleable form, the minerals had already undergone a chemical change through manufacturing process. This could not have been the state of "mineral products" that the law contemplates for purposes of imposing the *ad valorem* tax. It must be remembered that, as aforestated, this tax is imposed on the privilege of extracting or severing the minerals from the mines. To our minds, therefore, the inclusion of the term mineral products is intended to comprehend cases where the mined or quarried elements may not be usable in its original state without application of simple treatments, such as washing, or cutting them into sizes, which process does not necessarily involve the change or transformation of the raw materials into a composite, distinct product. Secondly, respondent cannot use the selling price of the product in this case as gauge of its actual market value. The cement here is manufactured by petitioner itself out of materials quarried from its mines. While the selling price of cement may reflect the actual market value of cement, said selling price cannot be taken as the market value also of the minerals composing the cement. And it was not the cement that was mined, only the minerals composing the finished product.

As a manufactured product it is subject to tax under Section 186 of the Revenue Code and subject to tax as it is, its value is deductible when used as material of another manufactured product such as the cement pipes and hollow blocks of petitioner. That the cement was not taxed as such because the Bureau erroneously thought that it was a mineral product under Section 246 of the Revenue Code and was subject only to the ad valorem tax provided in Section 243 of the same Code and not to the sales tax of manufacturers is of no consequence. There is nothing in the language of Section 186 of the Revenue Code that requires payment of the sales tax on the material as a prerequisite of the right to deduct the value of said material when used for manufacturing. The tax is of course presumed to be collected by the Bureau of Internal Revenue at the proper time and from the proper taxpayer - the cement manufacturer in this case.

The present question finds a parallel in the case of Armando L. Abad v. C.T.A. & Comm. of Internal Revenue, G.R. Nos. L-20834 & 20903, Oct. 19, 1966. In said case, the denaturer purchased ethyl alcohol from various suppliers for manufacture into denatured alcohol. Ethyl alcohol was then believed to be subject to specific tax and therefore exempt from the sales tax. No payment was made for the specific tax because the law then provided that ethyl alcohol used in denaturing may be withdrawn without payment of the specific tax. Respondent, however, for the first time, changed the then prevailing stand of the Bureau of Internal Revenue and assessed petitioner for deficiency sales tax on his sales of denatured alcohol without deducting the cost of ethyl alcohol as cost of raw material, no sales tax having been previously collected for said ethyl alcohol. The Supreme Court held:

> Coming now to the appeal of the Commissioner of Internal Revenue (G.R. No. L-20903): the only issue therein posed is whether or not the cost of ethyl alcohol purchased from other distilleries and used in the manufacture of completely denatured alcohol by petitioner Abad 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 deciding this point, the lower court opined that it was so deductible.
>
> Respondent Commissioner assails the conclusion of the lower court, contending that under section 164 of the Tax Code the purpose of the requirement of posting a bond before ethyl alcohol is withdrawn or removed for denaturing for use as fuel, light, and other purposes enumerated in Section 128 of the same Code is to free the distiller or producer thereof from paying any internal revenue tax, whether specific tax or percentage sales tax; that the sale of said ethyl alcohol is not subject to sales tax

under Section 186 nor under Section 189 of the same Code, it not being one of the articles taxable under the latter section; and this coupled with the admitted fact that the distiller or producer of said ethyl alcohol did not declare their sales, nor paid the sales tax thereon (citing the Tan Chiu case), petitioner Abad is precluded from deducting the cost of said ethyl alcohol from the gross selling price of the completely denatured alcohol, for purposes of computing the 7% sales tax imposed by Section 186 of the Tax Code.

If the completely denatured alcohol is free from specific tax, yet the ethyl alcohol from which it is made, though not listed as subject to sales tax under Sections 184, 185 and 185-A of the Tax Code, becomes subject to sales tax under the first part of Section 186, and its cost is deductible in the computation of the sales tax under the last part or proviso of the same section. It will be noted that the terms of Section 186 (first portion) are sufficiently broad to cover sales of such ethyl alcohol:

x x x x x

<u>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</u>.

x x x x x

<u>The fact that Abad's suppliers of ethyl alcohol did not pay sales tax thereon is no reason for burdening Abad with said tax</u>.

x x x x x

The Tan Chiu case, G.R. No. L-15008, January 28, 1960 relied upon by the Commissioner of Internal Rev-

> enue is not applicable to the case at bar, the ruling in that case being that the cost of the raw materials was not allowed to be deducted from the gross selling price of the finished product not because there was non-payment of the sales tax, but because the raw materials there were expressly exempted from taxes as used by new and necessary industries (Republic Act No. 901); and no sales tax has naturally expected to be paid thereon. (Underscoring ours.)

Consequently, it would seem that petitioner can deduct the cost of cement as cost of raw material from its gross sales of concrete products.

Lastly, respondent demands payment of ₱2,360.00 as compromise penalty. This is objected to by petitioner. It has been repeatedly held that ". . . a compromise implies agreement. One party cannot impose it upon the other. . ." (Comm. of Int. Rev. v. Abad, L-19627, June 27, 1969). The amount of ₱2,360.00 as compromise penalty cannot be collected from petitioner by respondent.

To summarize, petitioner is liable to pay deficiency sales tax and surcharge for the years 1959 and 1960 in the respective amounts of ₱2,224.15 and ₱1,053.18 or a total of ₱3,277.33, computed as follows:

	1959	1960
Gross sales	₱86,551.93	₱43,164.87
Less: Non-cement raw materials	24,728.59	14,129.73
Taxable Sales	₱61,823.34	₱29,035.14
Less: Raw materials - cement	26,771.75	8,612.60
Correct taxable sales	₱35,051.59	₱20,422.54
Tax Due thereon - 7%	2,453.61	1,429.58
Less: Tax already paid	674.29	587.04
Deficiency Sales Tax	₱ 1,779.32	₱ 842.54
25% surcharge	444.83	210.64
Total Amounts Due	₱ 2,224.15	₱ 1,053.18

WHEREFORE, the decision appealed from is modified. Petitioner is hereby ordered to pay to the Commissioner of Internal Revenue the sums of ₱2,224.15 and ₱1,053.18, or a total of ₱3,277.33, as deficiency sales tax and surcharge corresponding to the years 1959 and 1960, respectively. No costs.

SO ORDERED.

Quezon City, March 30, 1970.

RAMON L. AVANCEÑA
Associate Judge

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

ESTANISLAO R. ALVAREZ
Associate Judge