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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

December 6, 1960

TAN KIM KEE,
Petitioner,

- versus - C.T.A. CASE NO. 569

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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

DECISION

This is an appeal from a decision (p. 33 BIR rec.) of the respondent Commissioner of Internal Revenue denying petitioner's claim for refund of fixed and sales taxes paid by the latter on January 10, 1957 in the amounts of ₱40.00 and ₱1,254.24, respectively (Annex A, p. 13 CTA rec.) as a producer of copra.

The facts are not disputed. The parties have submitted the case for decision on the basis of their "Stipulation of Facts" (pp. 71-72 CTA rec.) and their pleadings.

It appears that the petitioner herein is a producer of copra which he sells to copra exporters in Davao City. He produces copra in two ways, namely, the sun-dried method and the kiln-dried method. (Pars. 1 & 2, Stipulation of Facts, p. 71 CTA rec.)

Under the sun-dried method employed by the petitioner, the nuts are first split into halves and are dried under the sun to partly loosen the meat from the shell. After one or two days of drying in that state, the meat is removed from the shell with an instrument designed for the purpose. To facilitate drying and handling, the meat so removed is chopped into small pieces and the same is dried under the sun for at least three days or until its moisture content is reduced to a minimum acceptable in the markets. (Par. 3, Stipulation of Facts.)

The processes involved in copra-making under the kiln-dried method employed by the petitioner are the same as the sun-dried method described above except that in the latter method, the nuts are first unhusked before being split into halves and the meat is dried in a kiln or oven heated with fuel. Further, the drying process which takes from 18 to 24 hours under the kiln-dried method, is shorter than the sun-dried method. (Par. 4, Stipulation of Facts.)

During the period from August 24, 1956 to December 31, 1956, inclusive, petitioner netted a gross sale on the copra it produced the total amount of ₱17,917.73 on which he paid to the Treasurer of Davao City, on January 10, 1957, the sum of ₱1,254.24 as the 7% sales tax imposed by Section 186 of the National Internal Revenue Code, as amended by Republic Act No. 1612. The petitioner paid also to the same official on the same date, fixed taxes (C-14) of ₱40.00 for the years 1956 and 1957, pursuant to Section 182 of the said Code. (Pars. 5 & 6, Stipulation of Facts; see also Official

Receipts Nos. C-146544 & C-14645, both dated Jan. 10, 1957, p. 1 BIR rec.)

On September 6, 1957, the petitioner filed with the respondent a claim for refund of the aforesaid taxes which claim was denied by the latter on November 22, 1957. Subsequently, or on February 7, 1958 and April 30, 1958, the petitioner filed his first and second requests for reconsideration of the denial of his claim for refund but said requests were also denied by the respondent on February 13, 1958 and July 1, 1958, respectively. (Pars. 8, 9 & 10, Stipulation of Facts.)

The petitioner, not being agreeable to the decision of the respondent denying his claim for refund, filed with this Court the present petition for review on August 12, 1958.

The only issue in this case is whether or not the petitioner, as a producer of copra, is subject to the fixed and percentage taxes prescribed in Sections 182 and 186 of the Tax Code, as amended by Republic Act No. 1612.

The determination of this lone issue depends on the interpretation of the provision of Section 188 (b) of the National Internal Revenue Code, as amended by Republic Act No. 1612 on August 24, 1956, the law applicable to the instant case inasmuch as the period under review is from August 24, 1956 to December 31, 1956 only.

Section 188 (b) of the Tax Code before it was amended by Republic Act No. 1612 provided 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
>
> "(b) Agricultural products and the ordinary salt when sold, bartered, or exchanged in this country by the producer or owner of the land where produced, as well as fish and its by-products when sold, bartered, or exchanged by the fisherman or fishing operator, whether in their original state or not." (Underscoring supplied.)

Prior to its amendment by Republic Act No. 1612, Section 188 (b) of the Tax Code, which is quoted above, exempted copra from the payment of percentage tax when sold, bartered, or exchanged by the producer or owner of the land where it was produced. As a matter of fact, even the canning of sliced pineapple, pineapple chunks, crushed pineapple, and pineapple juice from fresh pineapple fruits was declared by the Supreme Court as an exempt sale of agricultural products. In the words of the Supreme Court, speaking thru Mr. Justice J.B.L. Reyes, "The very text of the law (i.e., Sec. 188 (b) of the Tax Code prior to its amendment by Rep. Act No. 1612), in exempting 'agricultural products - - - whether in their original state or not,' makes it clear that the exemption is not divested merely because the products themselves have undergone processing of some kind." (Phil. Packing Corp. vs. Collector of Internal Revenue, G. R. No. L-9040, Dec. 26, 1956; 53 O.G. 8093.)

On August 24, 1956, Section 188 (b) of the Tax Code was amended by Republic Act No. 1612 to read 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
>
> "(b) Agricultural products and the ordinary salt in their original form when sold, bartered, or exchanged by the producer or owner of the land where produced. The term 'agricultural products' as used herein shall not include cultured fish and other products raised or produced in fishponds, and those which have undergone the process of manufacturing as defined in section one hundred ninety-four (x) of this Code." (Underscoring supplied.)

The Supreme Court, in comparing the provisions of Section 188 (b) of the Tax Code, before and after its amendment by Republic Act No. 1612, made the following observations:

> "Note that while the old provision exempts 'agricultural products x x x whether in their original state or not', the new amendment omitted the words 'or not', limiting the exemption to 'agricultural products x x in their original form', and further clarified the meaning of the phrase 'in their original form' as follows:
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> > 'the term agricultural products shall not include x x x those which have undergone the process of manufacturing as defined in section one hundred ninety-four (x) of this Code'.
>
> "By the very nature of the changes made in the original statute, it is clear that the amendment is intended, not to clarify the doubtful meaning of the former law, as contended by respondent, but to withdraw from the scope of the former exemption the agri-

cultural products that are no longer in their original form because they have undergone the process of manufacture; and this view is also supported by the explanatory note to House Bill No. 5809, the source of Republic Act No. 1612, wherein it is stated that 'all the proposed amendments to Title V of the National Internal Revenue Code' were aimed 'at greater revenue by imposing slight increase in tax rates and greater coverage of subject of taxation'.

"Of course, under the new amendment to sec. 188 (b) of the Tax Code, the products of petitioner Philippine Packing Corporation are now subject to percentage tax; but as Republic Act No. 1612 does not have any retroactive effect, there being no provision for its retroactive operation, it can only affect petitioner after, and not before, its passage and effectivity." (Phil. Packing Corp. vs. Collector of Internal Revenue, G. R. No. L-9040, Jan. 22, 1957; Resolution on the Motion for Reconsideration.)

In view of the above interpretation given by the Supreme Court to the term "agricultural products" which are not subject to percentage tax, under Section 188 (b) of the Tax Code, as amended by Republic Act No. 1612, the question in the case at bar narrows down to whether or not copra has "undergone the process of manufacturing as defined in section one hundred ninety-four (x) of" the Tax Code.

Section 194 (x) of the Tax Code provides:

"(x) 'Manufacturer' includes every person (1) who by physical or chemical process alters the exterior texture or form or inner substance of any raw material or manufactured or partially manufactured product in such manner as to prepare it for a special use or uses to which it could not have been put in its original condition, or (2) who by any such process alters the quality of any such

> raw material or manufactured or partially manufactured product so as to reduce it to marketable shape or prepare it for any of the uses of industry, or (3) who by any such process combines any such raw material or manufactured or partially manufactured products with other materials or products of the same or of different kinds and in such manner that the finished product of such process of manufacture can be put to a special use or uses to which such raw material or manufactured or partially manufactured products in their original condition could not have been put, and who in addition alters such raw material or manufactured or partially manufactured products, or combines the same to produce such finished products for the purpose of their sale or distribution to others and not for his own use or consumption." (Underscoring and numbering supplied.)

In the light of Section 194 (x) quoted above, and the comparative analysis given by the Supreme Court to Section 188 (b) of the Tax Code, prior to, and after its amendment by Republic Act No. 1612, we believe and so hold that the petitioner, for tax purposes, is a manufacturer of copra. Note that the statutory definition of the term "manufacturer" is so broad and comprehensive as to include a person who by physical or chemical process alters the quality of a raw material so as to reduce it to marketable shape. In the instant case, there can be no doubt that the petitioner in converting the fresh meat of matured coconuts into copra altered the quality of the fresh coconut meat by physical and chemical process, and reduced it to marketable shape. As a matter of fact, the petitioner admits that "a literal interpretation of this provision would, indeed, cover the case of your petitioner and make him a manufacturer simply because the drying out process of the nut alters the quality thereof so as to reduce it to marketable shape". (Petition for Review, p. 7, CTA rec.; see also Annex A, Reply to the Memorandum for the Respondent, p. 92, CTA rec.) We find this admission of the petitioner to be in accordance with the facts and the law in this case. And we wish to add that the petitioner is not only literally but also substantially within the purview and meaning of the term "manufacturer" as the same is defined in Section 194 (x) of the Tax Code.

The established tax jurisprudence in the Philippines shows that those who make nipa shingles from nipa leaves; or those who produce charcoal which is locally used for ironing clothes from wood; (Bermejo vs. Collector of Internal Revenue, 87 Phil. 96) or those who convert fresh eggs into salted eggs; (Ngo Siek vs. Collector of Internal Revenue, G. R. No. L-8989, Oct. 18, 1956; 52 OG 6873) or those who can sliced fresh pineapples; (Phil. Packing Corp. vs. Collector of Internal Revenue, supra., Resolution on the Motion for Reconsideration) or those who merely apply varnish and affix mirror or glasses to locally purchased furniture; (Yu Kuan vs. Collector of Internal Revenue, C.T.A. Case No. 270, Aug. 3, 1957) and those who transform raw kapok into clean, soft and light kapok by removing the seeds, cores, dirt and other foreign materials (Cosmos Kapok Factory vs. Araneta, C.T.A. Case No. 125, Mar. 29, 1957; see also Pacific Kapok Factory, C.T.A. Case No. 342, June 29, 1959, and Oriental Kapok Industry, C.T.A. Case No. 506, Nov.12, 1960) are considered "manufacturers" for tax purposes, and their products - "Philippine Manufactures". (See also Manila Trading & Supply Co. vs. City of Manila, G.R. No. L-12156, April 29, 1959; 56 OG 3629; Central Azucarera Don Pedro vs. City of Manila, G.R. No. L-7679, Sept. 29, 1956.)

In principle, we find no difference between them and the petitioner herein who converted the fresh coconut meat into copra in order that it could be marketable. Therefore, we rule that the petitioner is, for tax purposes, a manufacturer, and is subject to the fixed and percentage taxes prescribed in Sections 182 and 186 of the National Internal Revenue Code.

WHEREFORE, in view of the foregoing considerations, the decision of the respondent appealed from denying petitioner's claim for refund of fixed and sales taxes paid by the latter on January 10, 1957, in the amounts of ₱40.00 and ₱1,254.24, respectively, being as it is in accordance with law, the same should therefore be, as it is hereby affirmed, with costs against the petitioner.

SO ORDERED.

Manila, December 6, 1960.

AUGUSTO M. LUCIANO
Associate Judge

I CONCUR:

MARIANO NABLE
Presiding Judge

Associate Judge ROMAN M. UMALI
dissents in a separate opinion.

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DISSENTING OPINION

I regret my inability to add my concurrence to the majority opinion.

The question presented is whether or not a coconut planter who produces copra out of the coconuts produced by him is a manufacturer and is subject to the sales tax of 7% on his sales of such copra. The majority opinion says he is such a manufacturer, sustaining the ruling of respondent; I believe he is not.

The ruling of respondent is predicated upon the provision of Section 188(b), which reads:

> "The term 'agricultural products' as used herein shall not include cultured fish and other products raised or produced in fishponds, and those which have undergone the process of manufacturing as defined in section one hundred ninety-four (x) of this Code."

This provision was added by Republic Act No. 1612, which took effect on August 24, 1956. Before the amendment, a coconut planter who produced copra out of coconuts produced from his plantation was never considered a manufacturer within the meaning of Section 194(x) of the Revenue Code. Copra thus produced by a coconut planter remained an agricultural product, sales of which by the coconut planter were exempt from the sales tax. Because of the amendment, it is contended that copra even if produced by the coconut planter himself became a manufactured article. I do not think this interpretation is justified by the manifest intention of Congress or by the very language of the statute.

Section 188(b) of the Revenue Code, as amended by Republic Act No. 1612, eliminated from the definition of "agricultural products" only "those which have undergone the process of manufacturing as defined in section one hundred ninety-four (x) of this Code." The process of making copra by the coconut planter is not considered a process of manufacturing as defined in Section 194(x). The process of making copra by the coconut planter is merely part of the agricultural labor applied by the farmer to prepare his crop for the market. This has been the rule consistently followed and applied by the Bureau of Internal Revenue since time immemorial. It cannot be otherwise after the enactment of Republic Act No. 1612 because the processes that constitute manufacturing under Section 194(x) have not been enlarged or extended to include processes that are merely considered part of agricultural labor of the farmer.

This Court has expressed the view that "agricultural labor" is not a process of manufacturing within the meaning of Section 194(x). In American Rubber Company v. Collector of Internal Revenue, C.T.A. No. 111, June 14, 1956,[1] we stated:

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[1] The case is still pending appeal in the Supreme Court.

In order to do justice to the intention of the legislature in granting tax exemption to agricultural products, whether in their original state or not, when sold by the producer or owner of the land where produced, we should not rely solely on Section 194(x) and consider as manufactured articles all agricultural products which have undergone any form of alteration or transformation. That would nullify the legislative purpose in qualifying "agricultural products" appearing in Section 188 (b) by the phrase "whether in their original state or not." The only reasonable interpretation that can be given to the two provisions (Secs. 188/b/and 194 /x/, in order to harmonize them, is to consider as agricultural products those products which, although they have suffered changes or alterations, are the result of genuine agricultural labor. All other changes or alterations in an agricultural product not connected with agricultural labor make such products manufactured articles, and are, therefore, taxable under Section 186 in relation to Section 194(x). No hard and fast rule can be made as to what constitutes genuine agricultural labor which may suffice for every given situation. We confess it is rather a difficult task, and we shall not, therefore, make any attempt to define in precise terms what constitute genuine agricultural labor. Each case must be decided on its merits.

That the nature of the labor applied to or expended in the production and preparation for the market of an article (produced from an agricultural product) determines whether or not such article is a manufactured article or remains an agricultural product may be gleaned from the decision of the Supreme Court in Mercado v. Collector of Internal Revenue, 32 Phil. 271. Said the Supreme Court:

> "The rasing of plant shrub known locally as 'bakawan' and the gathering of its trunk and branches for use as firewood <u>constitute a genuine agricultural labor</u>, and, consequently sales of 'bakawan' as firewood raised in mangrove swamps are exempt from the merchants' sales tax." (Underscoring supplied.)

In that case it was held that firewood produced out of "bakawan" plants is not a manufactured article. If Section 194(x) is to be interpreted, firewood produced by cutting the stems, branches and twigs, and removing the leaves and unserviceable portions, of "bakawan" trees, cutting them into standard sizes and lengths, and tying or bundling the firewood into uniform sizes or weights, would constitute manufacturing. The Supreme Court rightly held that firewood so produced is not a manufactured article within the meaning of the law defining the term "manufacturer," the processes employed in the production of firewood being essentially agricultural labor.

x x x

The same may be said of Central Azucarera de Bais v. Trinidad (46 Phil. 492), . . . where the court . . . made a pronouncement which precisely runs counter to the stand taken by respondent in this case. We quote:

> "It is also suggested that following this argument to its logical conclusion (referring to the opinion that a sugar mill owner is a manufacturer), we would be compelled to hold that a sugar planter who has a small trapiche on his plantation wherein he converts his own cane into raw sugar is a manufacturer. We do not think that it would be necessary to so hold. A planter who devotes himself to the production of sugar cane and as an incident to such production works his product into a more convenient and valuable form is primarily a planter; his manufacturing is merely an incident to the management of his plantation. His case is manifestly different from that of the plaintiff corporation which, in effect, buys its raw material and devotes itself exclusively to converting it into finished merchandise. It may, perhaps, not always be easy to draw the line of demarcation between one business and the other, but difficulties of that sort are frequently encountered in the interpretation of the law." (Underscoring supplied.)

In this case, the Supreme Court very clearly expressed the opinion that a farmer who

> works his farm product into a more convenient and valuable form does not convert him into a manufacturer. That the farm product suffers alteration or transformation is immaterial, if the manufacturing process employed "is merely an incident to the management of his plantation," or, in the language used in Mercado v. Collector of Internal Revenue, supra, if the work employed constitutes a "genuine agricultural labor."

I wish to add that if respondent's ruling, to the effect that a coconut planter who produces copra out of coconuts produced from his own plantation is a manufacturer, is a correct interpretation of the law, then a coconut planter who merely removes the husk from the coconut to produce unhusked coconut would be a manufacturer and is subject to the sales tax on his sales of unhusked coconuts; and there are thousands of such farmers throughout the Philippines. The owner of an abaca plantation who produces abaca fiber by stripping abaca stems would be a manufacturer; there may also be thousands of them throughout the Philippines. Likewise, a rice planter who threshes palay harvested from his farm to produce clean palay for sale would be a manufacturer; and, undoubtedly, there are several thousands of such rice farmers. Has the Bureau of Internal Revenue made any attempt to assess and collect the sales tax from them?

It has been the consistent policy of Congress to encourage farmers by exempting from taxation agricultural products. As stated by the Supreme Court:

> "The first inquiry, therefore, must relate to the purpose the Legislature had in mind in establishing the exemption contained in the clause now under considera-

> tion. It seems reasonable to assume that it was due to the belief on the part of the law making body that by exempting agricultural products from this tax the farming industry would be favored and the development of the resources of the country encouraged. It is a fact, of which we take judicial cognizance, that there are immense tracts of public land in this country, at present wholly unproductive, which might be made fruitful by cultivation, and that large sums of money go abroad every year for the purchase of food substances which might be grown here. Every dollar's worth of food which the farmer produces and sells in these Islands adds directly to the wealth of the country. On the other hand, in the process of distribution of commodities to the ultimate consumer, no direct increase in value results solely from their transfer from one person to another in the course of commercial transactions. It is fairly to be inferred from the statute that the object and purpose of the legislature was, in general terms, to levy the tax in question, significantly termed the "merchant's tax," upon all persons engaged in making a profit upon goods produced by others, but to exempt from the tax all persons directly producing goods from the land. In order to accomplish this purpose the legislature, instead of attempting an enumeration of exempted products, has grouped them all under the general designation of "agricultural products." (Molina v. Rafferty, 38 Phil. 167.)

There has been no change in the attitude of Congress in giving preferential treatment to farmers. However, the ruling of respondent would be a radical departure from this time-honored policy. Coconut planters would be liable for the sales tax of 7%, while operators or proprietors of coconut oil mills and desiccated coconut factories are taxable only at the rate of 2% under Section 189. Also, abaca planters would be liable to the sales tax of 7% on sales of abaca fiber, while rope factories are taxable at the rate of 2%. Likewise, rice farmers would be taxable at 7% on their sales of palay, while owners of rice mills are taxable at 2%. I do not think Congress intended such a result when it enacted Republic Act No. 1612 amending Section 188 (b) of the Revenue Code.

Finally, as evidence that the interpretation given by respondent to the controversial amendment introduced by Republic Act No. 1612 was not in consonance with the spirit and intent of the law, Congress was quick to repeal the amendment, not because there was necessity for the repeal but in order to place on record the obvious intention of Congress and to cut short once and for all the injustice being committed by the continued enforcement of the "erroneous interpretation" given to the law by the Bureau of Internal Revenue. (See explanatory note to H. B. No. 6094, which became Rep. Act No. 1856; Vol. IV, No. 3, Congressional Records of the House of Representatives, dated Jan. 30, 1957, page 56.)

I vote to reverse the decision appealed from.

R. M. Umali
ROMAN M. UMALI
Associate Judge