REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

INTERNATIONAL PHARMACEUTICALS, INC., Petitioner,	C.T.A. CASE NO. 7752
	Members:
- versus -	ACOSTA, *Chairperson,* UY, *and* FABON-VICTORINO, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: DEC 21 2010 ; 11:26 am

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DECISION

***Fabon-Victorino, J.*:**

This Petition for Review filed by petitioner International Pharmaceuticals, Inc. on April 8, 2008, seeks to annul the Final Decision on Disputed Assessment (FDDA) dated January 25, 2008, issued by respondent Commissioner of Internal Revenue, finding it liable for deficiency excise taxes covering the period December 12, 2000 to August 6, 2003, in the total amount of P4,708,991.94.

THE FACTS

Petitioner International Pharmaceuticals, Inc. avers that it is a *bona fide* distiller with plant located at Brgy. Purisima, Manapla, Negros Oriental. It denatures ethyl alcohol using formulations approved by the Bureau of Internal Revenue (BIR). It has been issued permits as manufacturer, dealer, and re-packer of denatured alcohol which it sells to end-users who directly utilize the same as solvent or ingredient for the manufacture of small-scale cosmetic products[1].

Respondent, on the other hand, is duly authorized to assess and collect internal revenue taxes, as well as to decide assessments, with office at the 5th Floor, BIR National Office Building, Agham Road, Diliman, Quezon City[2].

On October 13, 2005, respondent issued a Preliminary Assessment Notice (PAN), assessing petitioner of excise tax deficiencies allegedly incurred from December 12, 2000 to August 6, 2003, in the total amount of P3,426,341.19,[3] itemized as follows:

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[1] Petition for Review (Petition), par. 1, Docket, pp. 2-3.
[2] Respondent's Memorandum, The Parties, par, 2, Docket, p. 225.
[3] Exhibit B, Docket, p. 13.

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1. Deficiency excise tax due on discrepancies of crude spirits for the production of denatured alcohol per book versus per count	P 71,954.27
2. Deficiency excise tax on tax-exempt alcohol delivered to non-permitees.	3,288,234.38
3. Deficiency excise tax of unaccounted volume of denatured alcohol per Annual Inventory Lists	66,152.54
TOTAL DEFICIENCY EXCISE TAX DUE	**P 3,426,341.19**

The deficiency assessment for deliveries of denatured alcohol to consignees not qualified to purchase tax exempt denatured alcohol was based on Section 44 (a) of Rules and Regulations No. 3 and Section 136 of the NIRC of 1997.

On January 28, 2004, respondent issued a Final Assessment Notice (FAN) over the alleged excise tax deficiencies for the same period in the modified amount of P3,562,682.50[4], computed as follows:

1. Deficiency excise tax due on discrepancies of crude spirits for the production of denatured alcohol per book versus per count (Schedules "A & B")	P 71,954.27
2. Deficiency excise tax on tax-exempt alcohol delivered to non-permitees. (Schedule "C")	3,424,575.69
3. Deficiency excise tax on unaccounted volume of denatured alcohol per Annual Inventory Lists (Schedule 'D")	66,152.54
TOTAL DEFICIENCY EXCISE TAX DUE	**P 3,562,682.50**

[4] Exhibit C, Docket, p. 21.

On April 5, 2005, petitioner filed a formal protest[5] impugning the validity of the foregoing FAN received on March 9, 2005.

On January 25, 2008, respondent issued the assailed FDDA canceling the amount of P71,954.27, representing the deficiency excise tax due on discrepancies of crude spirits for the production of denatured alcohol per book versus count. The assessment on excise tax deficiencies of Php4,708,991.94, inclusive of increments, pursuant to Section 47 of RR No. 3 and Sections 136 and 141(a) of the NIRC of 1997 computed up to January 31, 2008, was maintained as follows:

1. Deficiency excise tax on denatured alcohol delivered to non-permitees	P4,642,839.40
2. Deficiency excise tax on unaccounted volume of denatured alcohol	66,152.54
TOTAL DEFICIENCY EXCISE TAX DUE	**P4,708,991.94**[6]

It was stressed further that petitioner could not invoke prescription as a defense considering that it failed to file excise tax returns for the period covered by the assessment.[7]

[5] Exhibit D, Docket, p. 23.
[6] Exhibit E, Docket, p. 43.
[7] Exhibit E., Docket,p. 43.

On April 8, 2008, petitioner filed the instant Petition for Review challenging respondent's ruling in the FDDA.

On June 10, 2008, respondent filed Answer[8] to the Petition interposing the following counter-arguments:

> "5. The assessment for the period 12 December 2000 to 6 August 2003 in the amount of P4,708,991.94 was issued in accordance with law and regulations. The factual and legal bases of the subject assessment are contained in the Final Assessment Notice;
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> 6. More particularly, Section 47 of Revenue Regulations No. 3 and Section 136 of the 1997 NIRC, as amended, provides that in case of sale or deliveries of denatured alcohol to non-permitees, the buyer/user of denatured alcohol must be a holder of an approved formula and a valid permit.
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> Verifications of petitioner's books of accounts and other accounting records by the Revenue Officers revealed that there were deliveries of 122,460 g.l. or 231,449.40 p.l. denatured alcohol to various consignees who are not qualified to purchase tax-exempt denatured alcohol. Thus, said removals without payment of required excise taxes, were in direct violation of Revenue Regulations No. 3 and Section 136 of the 1997 NIRC, as amended;
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> 7. Further, the reconciliation of stocks per Annual Inventory List submitted by petitioner versus the Transcript of Official Register Book showed that there were discrepancies in the volume of denatured alcohol on hand as of the end of the years 2000 and 2002. Since no gain or loss was taken up in the books of petitioner, any unaccounted volume shall be subject to excise tax pursuant to the provisions of Section 136 and 141 (a) of the 1997 NIRC, as amended;

[8] Docket, pp. 67-73

8. The assessment was issued within the prescriptive period allowed by law. Section 222 (a) of the 1997 NIRC, as amended, provides:

> **"Section 222. Exceptions as to Period of Limitation of Assessment and Collection of Taxes.-**
>
> (a) In the case of false or fraudulent return intent to evade tax or of *failure to file a return*, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time *within ten (10) years after the discovery of the falsity, fraud or omission*: Provided, That in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof." (italics supplied)

It is very clear from the above-cited provision of law that in case the taxpayer failed to file a return, the tax may be assessed any time within ten (10) years after the discovery of the omission to file a return.

In the instant case, petitioner failed to file excise tax returns before removal of the subject denatured alcohol from the place of production for the period 12 December 2000 to 6 August 2003. Hence, the ten-year period under Section 222 (a) of the 1997 NIRC, as amended, applies;

9. Well-settled is the rule that tax assessments are entitled to the presumption of correctness and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner and approved by his superior officers will not be disturbed. All presumptions are in favor of the correctness of tax assessments (Sy Po vs. Court of Tax Appeals, 164 SCRA 524).

After the parties filed their respective Pre-Trial Briefs on July 01, 2008[9] and July 08, 2008[10], they submitted their Joint stipulation of Facts and Issues (JSFI) on July 30, 2008, which the Court approved on August 01, 2008.[11]

Trial ensued during which petitioner presented its evidence. Respondent, however, opted not to present any.[12]

On January 20, 2010, the Court deemed the instant petition submitted for decision after petitioner filed its Memorandum on December 7, 2009, and respondent, on December 8, 2009.

THE ISSUES

The parties limited the issues[13] for resolution as follows:

> "1. Whether or not petitioner's sale of denatured alcohol to its buyers is exempt from payment of excise tax under Section 141 (a) of the NIRC of 1997.

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[9] Respondent's Pre-Trial Brief, Docket, pp. 76-84.
[10] Petitioner's Pre-Trial Brief, Docket, pp. 85-90.
[11] Docket, p. 111.
[12] Minute Resolution dated October 22, 2009, Docket, p. 213.
[13] JSFI, Docket, p. 106.

2. Whether or not, under the facts and the law, petitioner is liable for deficiency excise tax for the period 12 December 2000 to 6 August 2003."

THE RULING OF THE COURT

Evidence reveals that petitioner was not served with the required Letter of Authority ("LoA") or Mission Order ("MO") to conduct the inventory verification, the result of which was the basis of the deficiency excise tax assessment. Hence, it behooves upon the Court to rule first on the validity of the examination of petitioner's books/inventories to properly determine the merit of the instant petition.

It bears stressing that an audit and examination of books to be lawful, must be based on a valid LoA empowering the assigned revenue officer to examine and scrutinize a taxpayer's books of accounts and other records to determine the tax liabilities. An LoA is issued by respondent or the Regional Director, if the taxpayer is under the jurisdiction of a Regional Office. It must be served on the subject taxpayer within thirty (30) days from date of issue lest the authority becomes null and void. The revenue officer, on the other hand, has 120 days from receipt of the LoA by the subject taxpayer, to conduct the examination and inspection.[14]

Paragraph 2 on the item "Policies" of Revenue Memorandum Order No. 3-2003,[15] specifically provides that inventory verification shall be authorized through: 1) Mission Order; **and** 2) letter to the subject taxpayer. Both the Mission Order and the letter to the taxpayer must be duly signed by the Assistant Commissioner, Large Taxpayers Service (ACIR, LTS)/concerned Regional Director. The provision reads as follows:

> 2. Inventory verification shall be authorized through a Mission Order (MO) (BIR Form 0422) (Annex "A") and a letter to the taxpayer (Annex "B") duly signed by the Assistant Commissioner, Large Taxpayers Service (ACIR, LTS)/concerned Regional Director.

Clearly, an inventory verification cannot be deemed lawful absent any of the foregoing requirements, the concurrence of which gives birth to a valid assessment.

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[14] BIR General Audit Procedures and Documentation.
[15] Prescribing Guidelines and Procedures in the Conduct of Inventory Taking/Stocktaking and Verification of Inventories Covering Taxable Year 2002 by the Large Taxpayers Audit and Investigation Division I, Large Taxpayers Audit and Investigation Division II, Large Taxpayers District Office — Makati, Large Taxpayers District Office — Cebu and Revenue District Offices.

Significantly, Revenue Officer Maria Anita Andres categorically testified that no Letter of Authority or Mission Order was issued to her and co-revenue officer Cecilio Refuerzo for the inventory stocktaking and examination of petitioner's books and records. On hand was only an Inter-office Memorandum [16] authorizing the conduct of actual physical count and reconciliation of inventories of petitioner. Moreover, they were not among those officially authorized to conduct the examination. They only acted upon the instruction of their team leader who was then conducting inventory stocktaking in another place in Bacolod City. The relevant portion of the testimony of Revenue Officer Maria Anita Andres is enlightening, thus:[17]

Atty. Espina:

Q. Madam Witness, among the records in the BIR, it appears that on August 6, 2003, you and certain Cecilio Refurzo (*sic*) signed a stocktaking report. Do you have a copy of the letter authorizing to proceed with the premises of the petitioner and to examine the goods of the petitioner and to conduct the inventory and stocktaking?

Ms. Andres:

A. Yes, your Honors.

Atty. Espina:

Q. May we have a copy of that?

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[16] Rollo, exhibit "G", p.146.
[17] TSN, September 2, 2008.

Ms. Andres:

A. I have here with me a duplicate copy, your Honors.

Justice Bautista:

Is that the duplicate original or just a Xerox copy?

Ms. Andres:

A. It's a duplicate of the original.

Atty. Espina:

Q. You are referring to this Memorandum dated March 11, 2003 signed by then Commissioner Guillermo R. Parayno, Jr.?

Ms. Anders:

A. Yes, your Honors.

Atty. Espina:

Q. Could you please point out to us, Madam Witness, your name and Refuerzo in that Memorandum?

Ms. Andres:

A. Actually, we are not here included in the Memorandum (*sic*) but I was one of the members of the stocktaking team. That time, we are conducting a simultaneous inventory stocktaking in Bacolod City, then our team head instructed me represent by herself (*sic*) to conduct at IPI Distillery Manapla, Bacolod.

Clearly, Revenue Officer Maria Anita Andres and Cecilio Refuerzo were not duly authorized to conduct inventory stocktaking at petitioner's premises. Neither were they empowered by any document to act in representation of their team leader who at that time was in another place conducting a like procedure against another taxpayer. Also, the failure to serve a Letter of Authority or Mission Order to petitioner before the intended conduct of examination was a significant deviation from the requirements of paragraph 2 on the item "Policies" of Revenue Memorandum Order No. 3-2003, rendering the result of such examination infirmed to substantiate an assessment.

Even granting that the Inter-office Memorandum would suffice for the purpose, it does not appear that it was served upon petitioner within 30 days from date of issue and that the inventory verification or inspection was conducted by the authorized revenue officer within 120 days from receipt of the Inter-Office Memorandum pursuant to the provision of the law. Such inventory verification can only be deemed valid if the requirements of the relevant rules are complied with, to wit: 1) informing petitioner (through a letter) of the intended stocktaking prior to the actual procedure; and 2) issuance of a LoA or Mission Order in favor of the specifically assigned revenue officer. Non-compliance of the foregoing requirements as in the instant case is fatal that it could render the result thereof inoperative.

In the case of Commissioner of Internal Revenue vs. Algue, Inc.,[18] the Supreme Court explained:

> "It is said that taxes are what we pay for a civilized society. Without taxes, the government would be paralyzed for lack of the motive power to activate and operate it. Hence, despite the natural reluctance to surrender part of one's hard-earned income to the taxing authorities, every person who is able must contribute his share in the running of the government, for its part, is expected to respond in the form of tangible and intangible benefits intended to improve the lives of the people and enhance their moral and material values. This symbiotic relationship is the rationale of taxation and should dispel the erroneous notion that it is an arbitrary method of exaction by those in the seat of power."
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> "But even if we concede the inevitability and indispensability of taxation, **it is a requirement in all democratic regimes that it be exercised reasonably and in accordance with the prescribed procedure**. If it is not, then the taxpayer has a right to complain and the courts will then come to his succor. For all the awesome power of the tax collector, he may still be stopped in his tracks if the taxpayer can demonstrate, as it has here, that the law has not been observed." (*Emphasis supplied*)

Even assuming that the two named revenue officers were duly authorized by respondent to conduct the inventory verification, still the deficiency excise tax assessment should be cancelled on substantive ground.

[18] G.R. No. L-28896, February 17, 1988, 158 SCRA 9.

Petitioner maintains that the assailed assessment has no factual or legal mooring. It has not violated any of the provisions cited by respondents in the impugned FDDA, specifically Sections 44 or 47 of the RR No. 3. Section 47 pertains to storage requirements for denatured alcohol and does not refer to or regulate the selling of denatured alcohol to non-permitees contrary to respondent's representation. Neither is there any requirement in Section 47 on the part of distillers, such as petitioner, to sell tax exempt alcohol only to a holder of formula and permit approved by BIR.

Moreover, a domestic denatured alcohol rendered unfit for human intake is exempt from excise tax pursuant to Section 134 of the 1997 Tax Code, thus:

> "SEC. 134. **Domestic Denatured Alcohol**.- Domestic alcohol of not less than one hundred eighty degrees (180°) proof (ninety percent [90%] absolute alcohol) shall, ***<u>when suitably denatured and rendered unfit for oral intake, be exempt from the excise tax prescribed in Section 141</u>***: *Provided, however*, That such denatured alcohol shall be subject to tax under Section 106 (A) of this Code: *Provided, further*, That if such alcohol is to be used for motive power, it shall be taxed under Section 148(d) of this Code*:* ***Provided, finally*, That any alcohol, previously rendered unfit for oral intake after denaturing but subsequently rendered fit for oral intake after undergoing fermentation, dilution, purification, mixture or any other similar process shall be taxed under**

> **Section 141 of this Code** and such tax shall be paid by the person in possession of such reprocesses spirits." (emphasis supplied)

From the foregoing, petitioner concludes that the only condition under which a tax exempt domestic denatured alcohol rendered unfit for human consumption becomes liable for excise tax is when the said denatured alcohol is **"subsequently rendered fit for oral intake after undergoing fermentation, dilution, purification, mixture or any other similar process"**.

Unless the domestic denatured alcohol sold to non-permitees were subsequently rendered fit for oral intake, there is no basis for the deficiency assessment.

Respondent counters that the assailed assessment for the period December 12, 2000 to August 6, 2003 is hinged on RR No. 3, Sections 130(a), 136 and 141(a) of the NIRC of 1997. According to respondent, the assessment was the result of the following findings:

1. Verification made by respondent disclosed that deliveries of 122,460 g.l. or 231,449.40 p.l. denatured alcohol were made to various consignees that are not qualified to purchase tax exempt denatured alcohol, in violation of Section 44(a) of Regulations No. 3 and Section 136 of the 1997 NIRC.

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2. Reconciliation of stocks per Annual Inventory Lists submitted by your company against the Transcript of the ORB showed that there were discrepancies in the volume of denatured alcohol as of the end of taxable years 2000 and 2002. The unaccounted discrepancies constitute receipts of untaxed alcohol taxable pursuant to Sections 130 (A) and 141 (a) of the 1997 NIRC, thus:

> "SEC. 130. **Filing of Return and Payment of Excise Tax on Domestic Products**.-
>
> (A) *Persons Liable to File a Return, Filing of Return on Removal and Payment of Tax*.-
>
> (1) *Persons Liable to File a Return*.- Every person liable to pay excise tax imposed under this Title shall file a separate return for each place of production setting forth, among others, the description and quantity or volume of products to be removed, the applicable tax base and the amount of tax due thereon: *Provided, however*, That in the case of indigenous petroleum, natural gas or liquefied natural gas, the excise tax shall be paid by the first buyer, purchaser or transferee for local sale, barter or transfer, while the excise tax on exported products shall be paid by the owner, lessee, concessionaire, operator of the mining claim.
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> Should domestic products be removed from the place of production without payment of the tax, the owner or person having possession thereof shall be liable for the tax due thereon
>
> xxx xxx xxx
>
> "SEC. 141. **Distilled Spirits**. - On distilled spirits, there shall be collected, subject to the provisions of Section 133 of this Code, excise taxes as follows:
>
> (a) If produced from the sap of *nipa*, coconut, *cassava, camote* or *buri* palm

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> or from the juice, syrup or sugar of the cane, provided such materials are produced commercially in the country where they are processed into distilled spirits, per proof liter, Eleven pesos and sixty-five centavos (P11.65);
>
> xxx xxx xxx

Respondent insists that in the sale/delivery of denatured alcohol to non-permitee, the buyer/user must be a holder of an approved formula and a valid permit issued by the BIR. This condition *sine qua non*, according to respondent, is expressly mandated in Section 47 of RR No. 3 and Section 136 of the NIRC of 1997, which read as follows:

> "Sec. 47. Denatured alcohol not to be stored on certain premises and not to be used for certain purposes. – Neither completely nor specially denatured alcohol shall be kept or stored on the premises of the following person, to wit: Dealers of wines, fermented liquors or distilled spirits; rectifiers (except such denatured alcohol as is manufactured themselves) and mixers of spirits; manufacturers of vinegar by the vaporizing process and the use of a still and mash, wort or wash; and any person who, in the course of business, has or keeps distilled spirits, wines, malt liquors, or other beverages on his premises: *Provided*, That druggists or grocers may be issued permits to deal in denatured alcohol, or to use denatured alcohol in manufacturing processes, **as authorized by law or regulations, where, upon careful inquiry being made, it shall satisfactorily appear that the applicant is entitled to the full confidence of the Collector of Internal Revenue and that the sale of such beverages, spirits, wines, or liquor is and will be incidental only to the business carried on by the applicant, and that**

> **such wines or liquors are not drunk on the premises of the dealer**: And provided further, That denatured alcohol intended solely for fuel, light, or other domestic uses and not for sale may be stored on the same premises with other distilled spirits, wines, or liquors if kept in a room separate from that wherein such spirits, wines, or liquors are stored. Where more than 15 gauge liters of denatured alcohol are stored on such premises at any one time, the same must be kept in a tank or room securely locked, but the privilege herein granted will in no case apply to premises where the business of rectifying, purifying, or compounding distilled spirits, wines or other liquors is carried on." (emphasis supplied)
>
> "SEC. 136. **Denaturation, Withdrawal and Use of Denatured Alcohol**. - Any person who produces, withdraws, sells, transports or knowingly uses, or is in possession of denatured alcohol, or articles containing denatured alcohol in violation of laws or regulations now or hereafter in force pertaining thereto shall be required to pay the corresponding tax, in addition to the penalties provided under Title X of this Code."

But Section 134 of the NIRC of 1997 explicitly provides that domestic alcohol of not less than one hundred eighty (180) degrees proof shall be exempt from the excise tax prescribed under Section 141, provided that such domestic alcohol is suitably denatured and rendered unfit for oral intake. The only condition in Section 141 that will render the domestic denatured alcohol subject to excise tax is when the said denatured alcohol is subsequently rendered fit for oral intake or consumption after a re-process through fermentation, dilution, purification, mixture or any other similar process. Under the said circumstance, the tax shall be paid by the person in possession of the re-processed spirits.

In other words, domestic denatured alcohol shall be subject to excise tax only when it is re-processed by means of fermentation, dilution, purification, mixture or any other similar process in order to make it fit for oral intake or human consumption.

In the instant case, there is no allegation or even insinuation that the domestic denatured alcohol, which was rendered unfit for oral intake sold by petitioner to its buyers, underwent re-processing enumerated under Section 141 to make it fit for oral intake or human consumption. No iota of evidence was presented to convince the Court that the domestic denatured alcohol sold by petitioner went through reprocessing to change its constitution making it fit for oral intake. It is clear from the record that the denatured alcohol sold by petitioner to its buyers remained to be unfit for oral intake or consumption.

Significantly, respondent failed to controvert petitioner's contention that it sold denatured alcohol to end-users who directly utilize the same as solvent or ingredient for small-scale production of cosmetic products. All told, petitioner's sale of denatured alcohol specifically to small-scale manufacturer of cosmetic products is tax-exempt pursuant to Section 134 of the 1997 NIRC.

WHEREFORE, finding merit, the instant *Petition for Review* is hereby **GRANTED**. The Final Decision on Disputed Assessment dated January 25, 2008, is hereby declared **NULL** and **VOID.** Accordingly, the assessment for deficiencies excise tax in the total amount of P4,708,991.94 for the period December 12, 2000 to August 6, 2003 is hereby **CANCELLED** and **SET ASIDE**.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

We concur:

(on leave)
ERNESTO D. ACOSTA
Presiding Justice

ERLINDA P. UY
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

ERLINDA P. UY
Associate Justice
Acting Chairperson

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

J. C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Acting Presiding Justice