Lib

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

ARNOLDUS CARPENTRY SHOP, INC.,
Petitioner,

- versus - C.T.A. CASE NO. 3357

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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

4/22/85

D E C I S I O N

Questioned in this petition for review is the decision of respondent Commissioner of Internal Revenue holding petitioner Arnoldus Carpentry Shop, Inc., liable for the amount of ₱108,720.92 as deficiency contractor's tax, inclusive of surcharge and interest, for the year 1977, pursuant to Sections 183(a) and 191 /now Sections 193(a) and 205, respectively/ of the National Internal Revenue Code.

The pertinent facts as alleged in the petition for review and admitted in the answer are:

Petitioner is a domestic corporation organized and existing under and by virtue of the laws of the Philippines, with principal address at the Christ the King Compound, 101 E. Rodriguez Sr. Blvd., Quezon City.

Sometime in March, 1979, the examiners of the Bureau of Internal Revenue conducted an investigation of the business tax liabilities of petitioner at the above address pursuant to Letter of Authority No. 08307 NA dated November 23, 1978.

On March 29, 1979, the said examiners, Messrs. Honesto A. Vergel de Dios and Voltaire V. Trinidad, made a report of their investigation to the Commissioner of Internal Revenue, classifying herein petitioner as a contractor, citing Luzon Stevedoring Co. v. Trinidad, 43 Phil. 809, alleging as reason for said classification that petitioner renders services in the course of an independent occupation representing the will of his employer only as to the result of his work and not as to the means by which it is accomplished. The said examiners assessed petitioner for deficiency tax in the total amount of EIGHTY EIGHT THOUSAND NINE HUNDRED SEVENTY TWO PESOS & TWENTY THREE CENTAVOS (₱88,972.23).

On January 31, 1981, petitioner received a letter/notice of tax deficiency assessment inclusive of surcharge and interest for the year 1977 in the amount of ONE HUNDRED EIGHT THOUSAND SEVEN HUNDRED TWENTY PESOS & NINETY TWO CENTAVOS (₱108,720.92). Said tax deficiency was due to the fact that the examiners of the Internal Revenue classified petitioner as a contractor instead of a manufacturer based on the Purchase Orders received from petitioner's customers.

On February 19, 1981, petitioner filed its protest and informed the public respondent that it was because of the 7% percent tax exemption on foreign sales granted under Section 202(e) of the National Internal Revenue Code to encourage exports, exploited foreign markets resulting to 52% increase in the total sales for 1977 through the sale of knockdown chairs, church benches, knife racks and barometer cases.

On June 23, 1981, petitioner received the final decision of the Commissioner of Internal Revenue, Ruben B. Ancheta, dated May 29, 1981 which stated thus -

> "It is the stand of this Office that you are considered a contractor and not a manufacturer. Records show that you manufacture woodworks only upon previous order from supposed manufacturers and only in accordance with the latter's own design, model number, color, etc.
>
> Accordingly, it is hereby requested that you settle the aforesaid assessment without further delay.
>
> This is our final decision and should you disagree, you may appeal to the Court of Tax Appeal within thirty (30) years from date of your receipt hereof; otherwise, this Office will take the necessary action to enforce the collection of the aforesaid assessment."

Averring that the aforesaid decision of the Commissioner of Internal Revenue is contrary to law and the facts of the case, petitioner filed its appeal to this Court on July 22, 1981.

As special and affirmative defenses, respondent alleged in his answer that:

Petitioner is a contractor under Section 205 of the 1977 Tax Code as amended, being engaged in the business of making woodworks like TV cabinets, upon previous orders from customers and in accordance with the latter's specifications.

The assessment for deficiency percentage tax for the year 1977 in the amount of ₱108,720.92 was made in accordance with law and regulations.

Being a contractor and not a manufacturer, petitioner is not entitled to the percentage tax exemption under Section 202 (formerly Section 188) of the Tax Code of 1977, as amended.

Is petitioner a manufacturer or a contractor for percentage tax purposes?

It is contended by respondent that since petitioner rendered service in the course of an independent occupation representing the will of its employer only as to the result of its work and not as to the means by which it is accomplished, petitioner should be considered a contractor and not a manufacturer. In support thereof, respondent presented letter-quotations from petitioner to its customers and purchase orders for television cabinets from local firms for various years starting from 1964 to 1979, all purporting to show that in placing such orders, petitioner's customers specified in detail the kind of cabinets they wanted. (Exhs. "2" to "13", pp. 1-13, BIR records.) Since these cabinets were manufactured exclusively for special customers, that is, the television-making firms which ordered them and not for the general public, respondent asserts that their manufacture were contracts for a piece of work and not contracts of sale. (Respondent's Memorandum, p. 177, CTA records.)

Article 1467 of the New Civil Code distinguishes a contract of sale from a contract for a piece of work as follows:

> "A contract for the delivery at a certain price of an article which the vendor in the ordinary course of his business manufactures or procures for the general market, whether the same is on hand at the time or not, is a contract of sale, but if the goods are to be manufactured specially for the customer and upon his special order, and not for the general market, it is a contract for a piece of work."

Sales of articles made upon previous orders of customers are generally not considered taxable sales. However, where the articles made upon previous orders are those which the manufacturer makes for sale to the public, the fact that a sale of such article is made upon previous order, because there was none in stock at the time, will not affect the taxability of the transaction as sale. (Gen. Cir. No. 509, Nov. 6, 1941; Inchausti vs. Cromwell, 20 Phil. 345; Celestino Co. vs. Collector of Internal Revenue, 99 Phil. 841; Commissioner of Internal Revenue vs. Engineering Equipment, L-27044, June 30, 1975, 64 SCRA 590.) Thus, for petitioner's transactions to fall under the category of sales, it must be shown that petitioner manufactured its woodwork products for the general market.

Petitioner claims, and the records bear petitioner out, that it had a ready stock of its shop products for sale to its foreign and local buyers. As a matter of fact, the purchase orders from its foreign buyers show that they ordered by referring to the models designated by petitioner. Even purchases by local buyers for television cabinets (Exhs. "2" to "13", pp. 1-13, BIR records) were by orders for existing models, except only for some adjustments in sizes and accessories utilized. Illustrations of some of these ready products, such as barometer cases, knife racks, churh furniture, chairs and several purchase orders from foreign buyers for the years 1977, 1978 and 1982 were offered by petitioner to substantiate its claim. (Exhs. "U", "U-1" to "U-7", pp. 104-108, BIR records; Exhs. "P", "Q", "Q-1" to "Q-3", pp. 36-44, CTA records.)

With regard to the television cabinets, petitioner presented three witnesses-its bookkeeper, production manager and manager who testified that samples of television cabinets were designed and made by petitioner, from which models the television companies such as Hitachi, National and others might chose, then specified whatever innovations they desired. If found to be saleable, some television cabinets were manufactured for display and sold to the general public. These cabinets were not exported but only sold locally. (t.s.n., pp. 22-35, February 18, 1982; t.s.n., pp. 7-10, March 25, 1982; t.s.n., pp. 3-6, August 10, 1983.)

Upon examination, petitioner's manager testified on the purchase orders for television cabinets as follows:

> "Q. In the purchase order, it states here . . . As per our drawing and approved sample. Would you know why the purchaser always make mention as per their drawings?
>
> A. We send them our model. Once they selected on the model, they will make a drawing from our sample and see how they can fit in the models imported." (t.s.n., p. 5, August 10, 1983.)

In the case of petitioner's other woodwork products such as barometer cases, knife racks, church furniture, school furniture, knock down chairs, etc., petitioner's above-mentioned witnesses testified that these were manufactured without previous orders. Samples were displayed, and if in stock, were available for immediate sale to local and foreign customers. Such testimony was not contradicted by respondent. And in all the purchase orders presented as exhibits, whether from foreign or local buyers, reference was made to the model number of the product being ordered or to the sample submitted by petitioner.

Respondent's examiners, in their memorandum to the Commissioner of Internal Revenue, stated that petitioner manufactured only upon previous orders from customers and "only in accordance with the latter's own design, model number, color, etc." (Exh. "1", p. 27, BIR records.) Their bare statement that the model numbers and designs were the customers' own, unaccompanied by adequate evidence, is difficult to believe. It ignores commonly accepted and recognized business practices that it is not the customer but the manufacturer who furnishes the samples or models from which the customers select when placing their orders. The evidence adduced by petitioner to prove that the model numbers and designs were its own is more convincing.

It is clear from the foregoing that petitioner manufactured its products for the general market. The fact that petitioner kept models of its products, including television cabinets, which were availed of by its local and foreign customers, indicate that these products were for sale to the general public and not for special orders. However, would certain specifications ordered by some customers on the television cabinet models as to material, finish, hardware, etc., be sufficient to divest petitioner of its character as manufacturer?"

The case of Celestino Co & Co. vs. Collector of Internal Revenue, No. L-8506, 31 August 1956, 99 Phil. 841, cited by petitioner, is in point. In this case, the Supreme Court held that:

> "A factory which habitually makes sash, windows and doors, and sells the goods to the public is a manufacturer. The fact that the windows and doors are made by it only when customers place their orders and according to such form or combination as suit the fancy of the purchasers does not alter the nature of the establishment."

Pertinent portions of the decision read as follows:

> "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.

xxx xxx xxx

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 purchase of manufactured goods held in stock for sale; they are bought because they meet the specifications desired by the purchaser.

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, 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.

xxx xxx xxx

It is at once apparent that the Oriental Sash Factory did not merely sell <u>its services</u> to Don Toribio Teodoro and Co. (To take one instance) because it also sold the materials. The truth of the matter is that it sold materials ordinarily manufactured by it - sash, panels, mouldings - to Teodoro & Co., although in such form or combination as suited the fancy of the purchaser. Such new form does not divest the Oriental Sash Factory of its character as manufacturer. Neither does it take the transaction out of the category of sales under Article 1467 above quoted, because although the Factory does not, in the ordinary course of its business, manufacture and keep on stock <u>doors of the kind</u> sold to Teodoro, it could stock and/or probably had in stock the sash, mouldings and panels it used therefor (some of them at least).

In our opinion when this Factory accepts a job that requires the use of extraordinary or additional equipment, or involves services not generally performed by it - it thereby contracts for a piece of work - filling special orders within the meaning of Article 1467. The orders herein exhibited were not shown to be special. They were merely orders for work - nothing is shown to call them special requiring extraordinary service of the factory."

In line with the ruling laid down in the afore-quoted decision of the Supreme Court, there seems to be no doubt that petitioner is a manufacturer for percentage tax purposes.

In computing petitioner's tax liability, respondent imposed the 3% contractor's tax on petitioner's total gross sales for 1977, local and export, on the ground that being a contractor and not a manufacturer, petitioner cannot avail of the percentage tax exemption on export sales.

Petitioner maintains that as a manufacturer, it is entitled to said tax exemption on its export sales under Section 188(e) /now Section 202(d)/ of the National Internal Revenue Code, the applicable provisions of which are 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-four-A, one hundred

> eighty-five, one hundred eighty-five-B and one hundred eighty-six, and one hundred eighty-six-B, transactions in the following commodities shall be excluded:
>
> xxx xxx xxx
>
> (e) Articles shipped or exported abroad by the manufacturer or producer, irrespective of any shipping arrangement that may be agreed upon which may influence or determine the transfer or ownership of the articles so exported: Provided, however, That sales to tourists, which are paid for in the foreign currency and on which sales tax had been previously paid, shall be considered export sales, if the articles purchased are actually removed by them from the Philippines upon their departure."

As per respondent's examination, the total gross sales of petitioner for 1977, local and export, amounted to ₱5,162,787.59. (Exhs. "1" and "14", pp. 24, 26, BIR records.) Petitioner's gross local sales as reported in its quarterly percentage tax returns for 1977 totalled ₱2,471,981.62. (pp. 16-19, BIR records.) The difference of ₱2,690,805.97 between petitioner's total gross sales of ₱5,162,787.59 and its gross local sales of ₱2,471,981.62 must be its gross export sales which is 52% of the total gross sales. This can be gathered from the letter of petitioner's manager to respondent Commissioner of Internal Revenue protesting the deficiency assessment, wherein he explained that it was on account of the 7% percentage tax exemption on export sales that petitioner exploited the foreign markets which resulted in the increase of its foreign sales to at least 52% of its total gross sales in 1977. (Exh. "16", p. 33, BIR records.)

In classifying petitioner as a contractor, respondent relied solely on the findings of his examiners from the purchase orders that television cabinets were ordered from petitioner in accordance with the customers' specifications. There were no such findings however insofar as the other products of petitioner were concerned, including those exported, which comprised 52% of the total gross sales. Thus, the seeming inconsistency, as petitioner puts it, of the basis of respondent's assessment for deficiency contractor's tax.

Respondent gave no other reason for imposing the 3% tax on petitioner's export sales aside from the fact that petitioner is allegedly an independent contractor taxable under Section 191 (now Section 205) of the Tax Code and not a manufacturer taxable under Sections 184, 184-A, 185, 185-B, 186 or 186-B of the Tax Code. (Respondent's memorandum, p. 180, CTA records.) Considering that we have found petitioner to be a manufacturer and not a contractor for percentage tax purposes, there is no question that petitioner is entitled to the percentage tax exemption on its export sales under Section 188(e) [now 202(d)] of the National Internal Revenue

Code. Accordingly, respondent erred in assessing petitioner for deficiency contractor's tax in the amount of ₱108,720.92, inclusive of surcharge and interest, for the year 1977.

WHEREFORE, the decision appealed from is hereby reversed.

SO ORDERED.

Quezon City, Metro Manila, April 22, 1985.

AMANTE FILLER
Presiding Judge

WE CONCUR:

CONSTANTE C. ROAQUIN
Associate Judge

ALEX Z. REYES
Associate Judge