REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

VMC SUGARCANE PLANTERS COOPERATIVE MARKETING ASSOCIATION, INC. (VICOMA),
Petitioner,

- versus -

C.T.A. CASE NO. 4570

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

6/23/93

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DECISION

This is an appeal from the decision of respondent dated July 4, 1990, received by petitioner's counsel on December 20, 1990, denying the protest filed in behalf of petitioner for lack of merit.

Records show that herein petitioner is a duly registered sugarcane planters marketing cooperative with principal office in Victorias, Negros Occidental. Its incorporation dates back to July 16, 1962, when its Articles of Incorporation and By-laws were duly registered with the Securities and Exchange Commission pursuant to the provision of Act No. 3425.

Petitioner is also an affiliated member of the Agricultural Credit and Cooperative Financing Administration as of July 18, 1962.

With the passage of Presidential Decree No. 388, as amended by Presidential Decree Nos. 775 and 1192, petitioner applied for a Certificate of Registration with the Philippine Sugar Commission (Philsucom). On June 7, 1973, Philsucom issued in favor of petitioner it's Certificate of Registration.

On March 17, 1986, petitioner received from the Bureau of Internal Revenue an assessment letter dated August 2, 1985, assessing it for deficiency income tax for the years 1981 and 1982. On the same date, petitioner received another assessment letter dated August 5, 1985, this time assessing it for deficiency business tax for the years 1981, 1982 and 1983.

The respondent's alleged Deficiency Income Tax Assessments for 1981 and 1982 amounting to P1,187,616.50 and P1,166,872.43, respectively, were computed as follows:

	1981	1982
Net savings for the year	P1,260,213.91	P1,286,864.80
Add: Discrepancies		
Office salaries/bonuses/ allowances	312,166.73	285,537.12
Management bonus	127,686.87	142,984.97
Understated income	69,178.22	81,521.43
Christmas gifts	45,337.44	77,907.11
Trucking refund	-	41,344.00
Director's per diem	18,900.00	25,900.00
Rent	29,245.00	28,225.00

Taxable income	P1,862,728.17	P1,970,284.43
Tax due thereon	P 641,954.86	P 679,599.55
25% surcharge	160,488.72	169,899.89
20% int. fr. 4-16-82 - 4-16-85	385,172.92	-
20% int. fr. 4-16-83 - 7-16-85	-	317,372.99
Total	P1,187,616.50	P1,166,872.43

On the other hand, the alleged Deficiency Business Tax Assessment covers petitioners' alleged failure to pay the privilege tax receipt as dealer of locally purchased articles for the years 1981, 1982 and 1983 amounting to P117,687.50, P105,187.50 and P92,687.50, respectively, itemized as follows:

	1981	1982	1983
Tax base	P23,881,973.06	P27,184,492.21	P38,057,163.99
Fixed tax due thereon	P 50,000.00	P 50,000.00	P 50,000.00
25% surcharge	12,500.00	12,500.00	12,500.00
Total	P 62,500.00	P 62,500.00	P 62,500.00
20% int. fr.			
2-01-81 to 9-01-85	55,187.50	-	-
2-01-82 to 9-01-85	-	42,687.50	-
2-01-83 to 9-01-85	-	-	30,187.50
Totals	P 117,687.50	P 105,187.50	P 92,687.50

On March 26, 1986, petitioner through counsel sent by registered mail its request for reconsideration and submits that as a sugarcane planters' cooperative it is exempt from the taxes assessed pursuant to the provision of Section 48 of Act No. 3425. On

December 20, 1990, petitioner received respondent's decision, dated July 4, 1990, denying its request for reconsideration.

Hence, an appeal was filed on January 16, 1991.

Petitioner contends that as a duly registered cooperative under Act No. 3425 and by its subsequent re-registration with the Philsucom under P.D. 388, as amended by P.D. 775 and P.D. 1192, and as implemented by the order issued by the Philsucom under Cooperatives Order No. 2, it had restored its status upon its creation with the same privileges and incentives therein provided. It cited as basis Section 48 of Act No. 3425 (approved on Dec. 9, 1928), as amended by Republic Act No. 702 (approved on May 9, 1952), which We quote in full:

> "SEC. 48. *Exemptions* - Any association organized under this Act shall not be subject to the payment of the merchant's sales tax, the income tax, and all other percentage taxes of whatever nature and description.
>
> Any exemptions under any and all existing laws applying to agricultural products in the possession or under the control of the individual producer, shall apply similarly and completely to agricultural products delivered by the farmer members to the association, or which are in the possession or under the control of the association."

Petitioner added that it is not organized for profit. Any price mark-up is intended to defray operating expenses. And any net savings realized at the end of each fiscal year are distributed among its members in proportion to their respective patronage during the preceding fiscal year. All put, it is not engaged in any business venture for profit.

Respondent on the other hand averred that petitioner deviated from its main function as a service cooperative by engaging in transactions not authorized by the law of its creation, such as:

> (a) Extends services to non-members corporations and partnerships (Sec. 7, Act No. 3425);
>
> (b) Fails to purchase, mill and market the sugarcane produced by its members, including the sale of molassis (*sic*) which is left entirely to the disposition of the members, a clear indication that it does not operate primarily for the material benefit of the members thereof (Sec. 1, supra.); and
>
> (c) Invests the funds of the association in money market placements instead of distributing the same to the members as dividends or as "members patronage refund".

The act of registration pursuant to Act No. 3425 and the subsequent re-registration with the Philsucom does not ipso facto grant the privilege of exemption to petitioner. But rather it is the compliance with the requirements of the cooperative law. The assessment is presumed correct. It is incumbent upon petitioner to prove the contrary.

The question to be resolved is whether or not petitioner has lost it's tax exemption privileges by reason of its alleged violation of Act No. 3425, as amended, and P.D. 388, as amended.

The Court deems it best to copy the pertinent portion of respondent's decision, dated July 4, 1990, subject matter of the present appeal, thus:

> "When the law grants privileges and incentives, such as exemption from the 'payment of the merchant's sales tax, income tax, and all other percentage taxes of whatever nature and description,' (Sec. 48, Act No. 3425, as amended) to associations registered thereunder as cooperatives, it simply means that they should operate as such and comply with the provisions and objectives of the law to qualify for said exemption. In other words, it is not enough that an association has registered as a cooperative with the proper government agency and has been issued a certificate of registration or re-registration.
>
> Investigations and verifications conducted by our examiner disclosed the following findings, which you failed to dispute and destroy, namely:
>
> > 1. Your client has corporations and partnerships, which are not cooperatives, as its members, and extends services to non-member corporations and partnerships. This is clearly in violation of the provision that an association, which is not organized under Act No. 3425 may not become a member or stockholder of any other association or associations organized thereunder (Sec. 7, supra) and the

prohibition that it shall not handle the agricultural products of any non-members, except for storage. [Sec. 6(a), supra].

2. VICOMA is supposed to purchase the sugarcane of sugar planter-members to be milled and the sugar produced to be marketed by it. It has ascertained, however, that it is not so. Actually, it was the planters who were the ones milling their own sugarcane and the marketing of the sugar produced was done by National Sugar Trading Corporation (NASUTRA). Furthermore, the selling of molasses is left entirely to the disposition of the planters. Obviously, these facts do not show that the association is operating primarily for the mutual benefit of the members thereof as mandated by law. (Sec. 1, Act No. 3425).

3. VICOMA is investing the funds of the association in money market placements instead of distributing them to the members as dividends or 'members' patronage refund.

The above activities of your client show that it has deviated from its main concept as a marketing cooperative as envisioned by Act No. 3425, as amended, for which reason, it loses its tax-exempt status or privilege.

Accordingly, your protest should be as it is hereby denied for lack of merit."

No evidence was presented by the respondent to support the findings of his examiner. Neither did he submit any memorandum for the guidance of this Court.

On the other hand, petitioner offered various evidence (Exhs. G, H and I) to show that in 1981, 1982 and 1983 it has been servicing its active members only. Petitioner had only 12 juridical entities for its members in the year 1981 out of a total of 238 members; 7 corporations out of a 220 total members in 1982; and only 4 corporation out of 222 members. Some of these corporations are Farms, others are engaged in the Agro-Industrial business, Realty and Estate Development.

The following provisions of Act No. 3425 is clear on this point:

> "**SEC. 2.** ***Definitions*** - As used in this Act:
>
> (a) The term 'agricultural products' shall include horticultural, forestry, dairy, livestock, poultry and any farm products.
>
> (b) The term 'association' means any corporation organized under this Act.
>
> (c) The term 'member' shall include actual members of associations without capital stock and holders of common stock in associations organized with capital stock.
>
> (d) The term 'person' shall include individuals, firms, partnerships, corporations and associations."

> "SEC. 7. ***Who may be members*** - Under the terms and conditions prescribed in the by-laws adopted by it, an association shall admit as members, or issue common stock only to persons engaged in the production of the agricultural products to be handled by or through the association, including the lessees and tenants of land used for the production of such products and any lessors and landlords who received as rent all or part of the crop raised on the leased premises.
>
> One association organized hereunder may become a member or stockholder of any other association or associations organized hereunder."

Note that Section 7 mentions persons and associations can both become members of the cooperative association. As defined in Section 2, "persons - includes individuals, firms, partnerships, corporations and associations; and associations - means corporations organized under Act No. 3425 [An Act providing for the organization of cooperative marketing associations]." The law does not mention only associations or corporations or partnerships which are also cooperatives. What the law provides is for the "person to be engaged in the production of the agricultural products to be handled by or through the association, including the lessees and tenants of land used for the production of such products and any lessors and landlords who received as rent all or part of the crop raised on the leased premises."

So far respondent has not pointed to any particular entity or person whom he thinks is not engaged in the production of sugar.

More so, respondent failed to substantiate his allegation that petitioner is servicing non-members. In fact, he failed to present any evidence on this regard.

With regard to the second finding that petitioner is supposed to purchase, mill, market and sell the sugarcane of its planter-members, petitioner stressed that no where in the marketing agreement was it mentioned that petitioner shall be required to purchase the sugarcane produced by its planters-members.

Petitioner is correct. The applicable provision of Act No. 3425 read:

> "SEC. 35. ***Marketing contract.*** - The association and its members may make and execute marketing contracts, requiring the members to sell, for any period of time, not over ten years, all or any specified part of their agricultural products, exclusively to or through the association. If they contract a sale to the association, it shall be conclusively held that title to the products passes absolutely and unreservedly, except for recorded liens, to the association upon delivery or at any other time specified in the contract. The contract may provide that the association may sell or resell the products delivered by its members, <u>with or without taking title thereto</u>; and pay over to its members the resale price, after deducting all necessary selling, overhead and other costs and expenses, including dividends on membership capital or capital stock actually subscribed and paid, and reserves for retiring the preferred stock, if any; and other proper reserves." (Emphasis Ours.)

The Marketing Agreement and Power of Attorney entered into between petitioner and it's member stipulates that the association shall undertake:

(a) to have the sugarcane produced in the above-mentioned plantations milled pursuant to existing milling contract;

(b) to sell, such sugars manufactured, together with the sugars of other producers; and

(c) to turn over to Producer the payment after making deductions to cover advances, interest upon advances and all costs incident to the management and production of such plantations and the manufacturing, storing, handling, and marketing of the sugars produced therefrom."

Petitioner is not required to purchase the sugarcane produced by its members. In fact, all that is required is for the planter-member to deliver the sugarcanes to the central for milling. Section 35 allows this kind of arrangement. Furthermore, with the enactment of Presidential Decree No. 388, as amended, Philsucom became the single buying and selling agency of sugar on the quedan-permit level. (Sec. 4.) Petitioner was certainly not in a position to market the sugar produce by its members during those period.

Lastly, respondent found that petitioner violated the law of its existence when it invested the funds of the association in money market placements instead of distributing them to the members as dividends or "members' patronage fund".

Petitioner presented Exhibits J, K and L together with their submarkings to prove that the balance of money market placements at the end of the fiscal year are taken up as Assets of the Association. All interest income earned therefrom forms part of the "Other Income" of the Association and reflected in the Statement of Operations. The investments are short term. As a matter of fact, the money market placements appeared in the Balance Sheet of the Association only for the years 1981 and 1982.

Section 6(e) of Act No. 3425 does not prohibit this kind of investment. The law even provides as one of the powers of a cooperative "to establish reserves and to invest the funds thereof in stock or bonds or in such other property as may be provided in the by-laws". We see no reason why petitioner should be faulted for investing its funds in money market placements.

Petitioner was not found by this Court to have violated the law of its creation. Hence, petitioner has the right and privilege to avail the incentives under Section 48 of Act No. 3425, which includes exemption from the income and all other percentage taxes of whatever nature and description, including the fixed tax.

WHEREFORE, finding the petition for review meritorious the same is hereby **GRANTED**. Respondent is hereby ordered to **cancel** the Deficiency Income Tax and Business Tax Assessments issued against petitioner for the fiscal years 1981, 1982 and 1983, totalling P2,670,051.43.

No pronouncement as to costs of suit.

SO ORDERED.

Quezon City, Metro Manila, June 23, 1993.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals