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Oct. 30, 1964

ALICIA O. ARCEGA and
RAF. L. ARCEGA, doing
business under the name
"FAIRMONT ICE CREAM COMPANY",
Petitioner,

C.T.A. CASE No. 574

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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

D E C I S I O N

This is a petition to review the decision, dated June 9, 1954, of the Commissioner of Internal Revenue holding the Fairmont Ice Cream Factory liable for the sum of ₱1,246.75, as fixed and deficiency percentage taxes for the years from 1949 to 1954, inclusive, 25% surcharge thereon and compromise penalty.

The Fairmont Ice Cream Company, which is owned and operated by the spouses Rafael L. Arcega and Alicia O. Arcega, is engaged in the manufacture, production and distribution of ice cream. Its main store and factory is located at 1432-1438 Taft Avenue, Manila. In order to provide outlets for the distribution and sale of its ice cream (Exhibit Y, BIR rec. p. 135), it established and operated branches at Taft Avenue PWU, Escolta, Rizal Avenue, Quezon Boulevard and Sta. Mesa Boulevard, all in the city of Manila (Exhibit 3, BIR rec. p. 8).

From the years 1949 to 1954, petitioners paid the privilege tax (fixed tax C-14) for their main store and factory. No fixed tax was paid for the branches on the belief that they were not liable therefor. During the same period, they paid the sales tax on the ice cream they manufactured, but, in computing the sales tax, the cost of the native eggs, fresh milk, mangoes, napkins, paper bags, wooden spoons, ice blocks, rock gas and soap, which were used in connection with the manufacture and sale of ice cream, was deducted from the gross sales. The native eggs, fresh milk and mangoes were used in flavoring and enriching the ice cream. The paper bags were utilized as wrappers and the ice blocks went with the ice cream to keep it in a refrigerated condition. The napkins and wooden spoons were used by customers who ate ice cream in the branch stores of petitioners. Rock gas was utilized as fuel for boiling the utensils, tablewares and other equipment and for preparing sandwiches sold in petitioners' branch stores. Soap was used in washing glasses, spoons and utensils (see Exhibit Y, BIR rec., pp. 141-148).

Sometime in 1954, the Commissioner of Internal Revenue caused the examination of petitioners' books for the years 1949 to 1954. It was discovered that the Fairmont Ice Cream Company failed to pay fixed taxes for its branches during the years 1952 to 1954. The examiners of the Bureau of Internal Revenue also found that the cost of native eggs, fresh milk, mangoes, napkins, paper bags, wooden spoons, ice blocks, rock gas and washing soap was deducted from the gross sales when petitioners paid the sales tax on the ice cream. Consequently, they recommended the disallowance of the cost deduction as shown in their report, to wit:

Period	Amount of Materials Disallowed	Deficiency Tax	
1949	₱ 517.30	₱ 25.85	
1950 (Jan to Sept 22)	1,049.56	52.48	
1950 (Sept 23 to Dec)	345.60	24.20	
1951	2,030.60	142.11	
1952	2,635.25	184.47	
1953	668.96	46.83	
1954 (Jan-Mar)	4,820.70	337.45	
	Total ----------------	₱ 813.41	
	Add: 25% surcharge	203.35	₱1,016.76

Unpaid taxes for the different branches:

Taft Avenue Branch, PWU (1952-54)	30.00	
Escolta Branch (1952-54)	30.00	
Rizal Avenue Branch (1953-54)	20.00	
Quezon Blvd. Branch (1953-54)	20.00	
Sta. Mesa Blvd. Branch (1952-54)	30.00	130.00
Total tax due		₱1,146.76
Compromise		114.68
Total amount due and collectible		₱1,261.44

(Exhibit 2, BIR rec. p. 6)

On the basis of the examiners' report, dated May 8, 1954, respondent, in his letter dated June 9, 1954, assessed against Fairmont Ice Cream Factory fixed and deficiency sales taxes and surcharge for the years 1949 to 1954 in the total amount of ₱1,146.75, itemized as follows:

5% tax due on ₱62,179.26 (taxable sales from 1949 to 9/22/50	₱ 3,108.96
7% tax due on ₱179,482.23 (taxable sales from 9/23/50 to 3/31/54	12,563.76
Total tax due	15,672.72

Less: Taxes paid	₱ 14,859.32
Deficiency tax	813.40
25% surcharge thereon	203.35
Deficiency tax and surcharge	1,016.75
Fixed tax C-14 for different branches:	
Taft Avenue Branch PWU (1952-54)	30.00
Escolta Branch (1952-54)	30.00
Rizal Avenue Branch (1953-54)	20.00
Quezon Blvd. Branch (1953-54)	20.00
Sta. Mesa Blvd. Branch (1952-54)	30.00
TOTAL AMOUNT DUE	₱ 1,146.75
(Exhibit 3, BIR rec. p. 8)	

A warrant of distraint and levy (Exhibit 4, BIR rec. p. 14) having been issued against it, Fairmont Ice Cream Company protested said warrant (Exhibit M, BIR rec. p. 17). Later, it requested for a re-investigation of the case (Exhibit N, BIR rec. p. 22; Exhibit O, BIR rec. p. 28). At the same time, it filed with respondent a waiver of the statute of limitations, which contained a proviso that it (waiver) "does not apply to taxes already prescribed under the law."

After a series of investigations, including a hearing before the Appellate Division of the Bureau of Internal Revenue, respondent denied the request of petitioners to cancel or withdraw the assessment (Exhibit 6, BIR rec. pp. 153-154). Hence, this appeal.

The resolution of this case hinges on the following questions, to wit:

(1) Has the right of respondent to assess and collect the fixed and deficiency percentage taxes for the years 1949 through 1954 prescribed?;

(2) Are the costs of native eggs, fresh milk, mangoes,

napkins, paper bags, wooden spoons, ice blocks, rock gas and washing soap which were used in the manufacture and subsequent sale of ice cream deductible from the gross sales for purposes of computing the sales tax imposed in section 186 of the Tax Code?;

(3) Are petitioners liable for the payment of fixed tax for each and every branch store they established and operated? and

(4) Are petitioners liable for 25% surcharge for late payment?

We shall discuss first the question whether or not respondent's right to assess and collect the taxes in question has prescribed.

The Commissioner of Internal Revenue may assess internal revenue taxes within five (5) years after the filing of the return. After the expiration of said period no proceeding in court for the collection of such taxes may be begun (Sec. 331, N.I.R.C.). However, where no return is filed or the return filed is false or fraudulent with intent to evade tax, the tax may be assessed or a proceeding in court for the collection of such tax may be begun without assessment within ten (10) years after the discovery of the falsity, fraud, or omission (Sec. 332, N.I.R.C.).

Petitioners contend that the fixed and deficiency sales taxes in question were assessed on June 9, 1954 and

July 17, 1958, beyond the prescriptive period set in Section 331 of the Tax Code. On the other hand, respondent maintains that from May 8, 1954, the date BIR Agents Alvarez and Alejo made their examination report on petitioners' tax liability, he has ten (10) years within which to assess the taxes in question because petitioners failed to show that they filed quarterly returns. Moreover, he avers that petitioners waived the statute of limitations.

We observe from Exhibit 1 that petitioners paid the sales tax on the ice cream on the following dates:

1949	
1st quarter	April 20, 1949
2nd "	July 19, 1949
3rd "	October 20, 1949
4th "	January 17, 1950
1950	
1st quarter	April 20, 1950
2nd "	July 20, 1950
3rd "	October 20, 1950
4th "	January 20, 1951
1951	
1st quarter	April 20, 1951
2nd "	July 20, 1951
3rd "	October 17, 1951
4th "	January 19, 1952
1952	
1st quarter	April 21, 1952
2nd "	July 17, 1952
3rd "	October 20, 1952
4th "	January 20, 1953

1953

1st quarter	April 20, 1953
2nd "	July 20, 1953
3rd "	October 20, 1953
4th "	January 20, 1954

1954

1st quarter	April 20, 1954

Considering the requirement laid down in Section 183 of the Tax Code in the payment of percentage taxes, we cannot presume from petitioners' failure to present evidence that quarterly returns were filed, that they did not file said returns. Section 183 requires every person conducting a business on which a percentage tax is imposed, within 20 days after the end of each calendar quarter, to make a true and complete return of the amount of the gross sales, receipts, or earnings, or gross value of output actually removed from the factory or mill warehouse during the preceding calendar quarter and pay the tax due thereon. In other words, the law requires that the filing of the return and the payment of the tax be made simultaneously. The reason is obvious. The return serves as the basis upon which the tax collector determines the amount of tax due at the time the taxpayer pays the tax. Since petitioners paid the sales tax due from them, as indicated above, we cannot but conclude that they filed the corresponding returns at the time they paid the tax and that the tax collector regularly performed his duty by determining and receipting the tax upon quarterly returns filed with and submitted to him.

Moreover, we gather from the examination report, Exhibit 2, of BIR Agents Alvarez and Alejo that the deficiency sales tax resulted from the disallowance of deduction items claimed by petitioners. The mere fact that petitioners claimed deductions from their gross sales indicates that returns were filed, for where else would they claim such deductions? How and from what source did the agents derive the information on the deductions claimed by petitioners and thereafter recommend the disallowances, if not from the returns themselves?

Finally, the agents of respondent did not charge petitioners with failure to file returns. Consequently, no such surcharge was imposed in respondent's letter of assessment of June 9, 1954, Exhibit 3.

With regard to the waiver of the statute of limitations made by petitioners, suffice it to say that said waiver, by express proviso therein, did not apply to taxes already prescribed. 3

It appears that the assessment in this case was issued on June 9, 1954. Applying the provisions of Section 331 of the Tax Code, the right to assess the taxes prescribed after five years from the filing of the returns. Therefore, in the case at bar, only the right to assess the deficiency sales tax for the first quarter of 1949 in the sum of ₱12.40 has prescribed.

We come now to the question whether or not the cost of native eggs, fresh milk, mangoes, napkins, paper bags, wooden spoons, ice blocks, rock gas and washing soap may be deducted from the gross sales in computing the sales tax on the ice cream under Section 186 of the Tax Code.

Prior to its amendment by Republic Act No. 588 on September 22, 1950, Sec. 186 of the Tax Code provided:

> "SEC. 186. Percentage tax on sales of other articles. -- There is levied, assessed and collected once only on every original sale, barter, exchange, and similar transaction intended to transfer ownership of, or title to, the articles not enumerated in sections one hundred eighty-four and one hundred eighty-five a tax equivalent to five per centum of the gross selling price or gross value in money of the articles so sold, bartered, exchanged, or transferred, such tax to be paid by the manufacturer, producer, or importer: Provided, That where the articles are manufactured out of materials subject to tax under this section, the total cost of such materials, as duly established, shall be deductible from the gross selling price or gross value in money of the manufactured articles. (Underscoring supplied)

Although Section 186 underwent several amendments, the above underscored proviso remained the same until it was amended by Republic Act No. 1612 which took effect on August 24, 1956. This case covers only the period from 1949 to 1954.

Petitioners contend that, pursuant to Section 188 of the Tax Code, the cost of native eggs, fresh milk and mangoes, being agricultural products, should be excluded from the gross sales in computing the sales tax imposed in Section 186. Section 188 reads in part:

> "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, whether in their original state or not."

On the other hand, respondent contends that only the cost of those materials subject to tax under Sections 186 and 189 may be deducted from the gross selling price of ice cream.

There is no question that native eggs, fresh milk and mangoes were used by petitioners as ingredients in the manufacture of ice cream. There would also be no dispute as to their deductibility if said raw materials were previously subjected to percentage tax under section 186. But since these ingredients were not subjected to percentage tax, their cost is not deductible.

With respect to the wooden spoons, napkins, paper bags, ice blocks, rock gas and soap, petitioners maintain that they are allowable deductions from the gross selling price of ice cream inasmuch as they were used in the manufacture and ultimate distribution of said ice cream. On the other hand, respondent contends that only those raw materials, which were actually used in the manufacture of ice cream, are deductible. Accordingly, wooden spoons, napkins, paper bags, ice blocks, rock gas and soap, which were not so used are not deductible.

There is no statutory authority for deducting the cost of the wooden spoons, napkins, rock gas and soap. The cost of these items was a mere operating expense in petitioners' business. Under section 186 of the Tax Code, the cost of materials out of which an article is manufactured is deductible from the gross selling price of the latter. Inasmuch as the ice cream in question was not manufactured out of the wooden spoons, napkins, rock gas and soap, the cost of the latter cannot be deducted from the gross selling price of the ice cream.

However, it appearing that the paper bags were used in the sale of petitioners' ice cream as wrappers, and the ice blocks as refrigerants, they were a part of the finished product (see La Tondeña, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 1017, November 9, 1962). Their cost is deductible.

The next issue pertains to the liability or non-liability of petitioners for the payment of fixed tax (C-14) for each of their branch stores. Section 178 of the Tax Code, which states:

> "SEC. 178. Payment of privilege taxes.--
> "x x x The tax on business is payable for every separate or distinct establishment or place where business subject to the tax is conducted; x x x"

is too clear to require further discussion on this issue. Undoubtedly, petitioners are liable to pay the fixed tax for each and every establishment they operate.

Petitioners question the imposition of the 25% surcharge for late payment of the percentage tax. The imposition of the 25% surcharge for late payment under section 183 of the Tax Code is mandatory and cannot be left to the discretion of the tax collector (Rep. of the Philippines vs. Luzon Industrial Corporation, et al., G.R. No. L-7992, October 30, 1957). It is incumbent upon the taxpayer to file correct quarterly returns and to pay the full tax declared therein. For any error made by him, he and he alone is accountable.

Petitioners' tax liability is computed hereunder:

Taxable sales (2nd qtr. of 1949 to 9/22/50 per finding of BIR agents (Exh. 1)		₱52,137.46
Less: Cost of paper bags ...	₱42.38	
Cost of ice .... (Exh. A)	94.62	137.00
Taxable sale		52,000.46
5% tax due thereon		2,600.02
Taxable sales (9/23/50 to 3/31/54) per finding of BIR agents (Exh. 1)		179,482.23
Less: Cost of paper bags ..	₱ 122.12	
Cost of ice	141.35	263.47
Taxable sale		179,218.76
7% tax due thereon		12,545.31

Total sales tax due	₱ 15,145.33
Less: Tax paid	14,369.63
Deficiency tax	775.70
25% surcharge thereon	193.92
Deficiency tax and surcharge	969.62
Fixed tax (C-14) for branches:	
Taft Avenue Branch FWU (1952-54).	30.00
Escolta Branch (1952-54)	30.00
Rizal Avenue Branch (1953-54) ...	20.00
Quezon Blvd. Branch (1953-54) ...	20.00
Sta. Mesa Branch (1952-54)	30.00
	₱ 1,099.62

(Note: As no breakdown was presented for the 1st quarter of 1949 and the last quarter of 1950, one-fourth of the yearly cost of paper bags and ice was allocated for one quarter.)

With respect to the ₱100.00 compromise penalty, the Commissioner of Internal Revenue lacks the authority to impose the same upon the taxpayer (Collector of Internal Revenue vs. University of Santo Tomas, G.R. No. L-11274, November 28, 1958; Collector of Internal Revenue vs. Bautista, G.R. No. L-12250, May 27, 1959).

IN VIEW OF THE FOREGOING CONSIDERATIONS, the decision appealed from is hereby modified. Petitioners are hereby ordered to pay the total sum of ₱1,099.62 as fixed and deficiency sales taxes, inclusive of surcharge. With costs against petitioners.

SO ORDERED.

Quezon City, October 30, 1964.

MARIANO [illegible]
Presiding Judge

WE CONCUR:

[illegible]TO M. LUCIANO
Associate Judge

ROMAN M. UMALI
Associate Judge