REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

LA SUERTE CIGAR AND CIGARETTE FACTORY, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 5527

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
FEB 15 1999

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# DECISION

The decisive issue that comes to the fore for our consideration is whether or not Petitioner's bulk purchases of stemmed leaf tobacco from foreign tobacco manufacturers are exempt from the payment of specific taxes, hence, Petitioner is entitled to the refund of the specific taxes it paid for the month of May, 1995, in the amount of ₱118,350.00.

As represented, Petitioner is a domestic corporation principally engaged in the manufacture of cigarettes out of stemmed-leaf tobacco which it purchased in bulk from both local and foreign tobacco manufacturers.

During the month of May, 1995, Respondent collected from Petitioner the aggregate amount of ₱118,350.00, allegedly representing the specific taxes due on its bulk purchases of stemmed-leaf tobacco from foreign tobacco manufacturers, broken down as follows:

| Date | Quantity of Stemmed-leaf tobacco purchased | ATAPET SERIAL NUMBER | Amount of Tax Paid | Exh. |
|---|---|---|---|---|
| 5-04-95 | 138,600 Kgs. | 2045164 | P103,950.00 | A |
| 5-04-95 | 19,200 Kgs. | 2045166 | 14,400.00 | B |
| | | | P118,350.00 | |

The said amount was paid by Petitioner under protest.

On September 27, 1996 and October 2, 1996, Petitioner filed with Respondent claims for the refund of specific taxes it paid on imported stemmed leaf tobacco during the period October, 1994 to May, 1995, which included the amount of P118,350.00 claimed in the herein petition.

The same was not acted upon by the Respondent, hence, on May 2, 1997, Petitioner filed with this Court the instant Petition for Review, which avers that:

> I. The collection under Section 141(b) of the Tax Code of the P0.75/kilo excise tax on sales of stemmed-leaf tobacco to be used in the manufacture of cigarettes, is erroneous and/or illegal for the following reasons: a) Section 137 is the applicable provision, b) the administrative practice of the BIR since 1939 was not to subject stemmed leaf tobacco to excise tax, c) payment of specific tax on stemmed leaf tobacco amounts to double taxation because excise tax is again paid on the finished product, i.e., cigarettes, d) Section 141 is a general provision of law and does not apply to stemmed leaf tobacco, e) sale of partially manufactured tobacco is exempt from specific tax under Revenue Regulations No. 17-67, f) BIR ruling supports La Suerte's position, g) authority on tobacco law states that sale from one manufacturer to another is

exempt from tax, and h) even if La Suerte is originally liable, it can no longer be held liable for specific tax at the present time.

II. Assuming arguendo, specific tax was due, the amount collected was erroneous.

On the other hand, Respondent, in her Answer, raised the herein special and affirmative defenses, thus: (1) Petitioner has no cause of action against Respondent, (2) under Revenue Regulations No. 17-67, specifically Sec. 1, paragraph 1 thereof, stemmed leaf tobacco is considered partially prepared tobacco thus subject to specific tax under Section 141(b) of the Tax Code, (3) imported stemmed leaf tobacco is subject to excise tax, pursuant to Section 128 of the Tax Code, (4) the application of exemptions under Section 137 of the Tax Code is not without limitations, therefore, applies only to local sales of stemmed leaf tobacco and if the sale is by one L-7 permittee directly to another L-7 permittee, (5) Petitioner has not shown that it falls squarely under Section 42(a) of Revenue Regulations No. 17-67, (6) assuming, that the BIR failed to subject stemmed leaf tobacco to specific tax, such failure does not bar the government from collecting, since the government is never estopped from collecting legitimate taxes due to the mistake of its agents, (7) BIR Ruling, dated December 12, 1972, which states that the sale of partially manufactured tobacco by an L-6/L-3R permittee to an L-7 1/2 permittee may also be allowed without prepayment of the specific tax, is erroneous, (8) the imposition of specific tax on stemmed leaf tobacco would not amount to double taxation in the prohibited sense, even if specific tax is also imposed on the finished product of which stemmed leaf tobacco is an integral part, for the reason that the tax is imposed on two different subject matters, namely, stemmed leaf tobacco and cigarettes, (9) in an action for tax refund, the burden of proof is on the taxpayer to establish its right to the refund and it is incumbent upon the herein Petitioner to show compliance with the provisions of Sections 204 and 230 of the Tax Code, and (10) tax refunds are construed strictly against claimants since they partake of the nature of exemption from taxation.

As earlier adverted to, the issues in this case may be simplified into one and, that is, whether or not Petitioner's bulk purchases of stemmed leaf tobacco from foreign tobacco manufacturers are exempt from the payment of specific taxes, hence, Petitioner is entitled to the refund of the amount of ₱118,350.00, allegedly representing the specific taxes it paid on such purchases during the month of May, 1995.

Petitioner and Respondent both agree that the resolution of this case centers on Sections 137, 128 and 141(b) of the 1995 Tax Code, to wit:

"Section 137. ***Removal of tobacco products without prepayment of tax.*** - Products of tobacco entirely unfit for chewing or smoking may be removed free of tax for agricultural or industrial use, under such conditions as may be prescribed in the regulations of the Department of Finance. Stemmed leaf tobacco, fine cut shorts, the refuse of fine-cut chewing tobacco, scraps, cuttings, clippings, stems or midribs, and sweepings of tobacco may be sold in bulk as raw material by one manufacturer directly to another, without payment of the tax under such conditions as may be prescribed in the regulations of the Department of Finance.

"Stemmed leaf tobacco" as herein used means leaf tobacco "which has had the stems or midribs removed. The term does not include broken leaf tobacco." (Underscoring supplied)

**Section 128.** ***Payment of excise taxes on imported articles.*** - *(a) Persons liable.* - Excise taxes on imported articles shall be paid by the owner or importer to the customs officers, conformably with the regulations of the Department of Finance and before the release of such articles from the customshouse, or by the person who is found in possession of articles which are exempt from excise taxes other than those legally entitled to exemption.

In the case of tax-free articles brought or imported into the Philippines by persons, entities, or agencies exempted from tax which are subsequently sold, transferred or exchanged in the Philippines to non-exempt persons or entities, the purchasers or recipients shall be considered the importers thereof, and shall be liable for the duty and internal revenue tax due on such importation. The tax due on such article shall constitute a lien on the article itself, superior to all other charges or liens, irrespective of the possessor thereof.

*(b) Rate and basis of the excise tax on imported articles.* - Unless otherwise specified, imported articles shall be subject to the same rates and basis of excise taxes applicable to locally manufactured articles.

"**Section 141.** ***Tobacco Products.*** - There shall be collected a tax of seventy-five

> <u>centavos on each kilogram</u> of the following products of tobacco:
>
> (a) x x x
>
> (b) Tobacco prepared or partially prepared with or without the use of any machine or instruments or without being pressed or sweetened; and
>
> (c) Fine-cut shorts and refuse, scraps, clippings, cuttings, stems and sweepings of tobacco.
>
> Fine-cut shorts and refuse, scraps, clippings, cuttings, stems and sweepings of tobacco resulting from the handling or stripping of whole leaf tobacco may be transferred, disposed of, or otherwise sold, without prepayment of the specific tax herein provided for under such conditions as may be prescribed in the regulations promulgated by the Secretary of Finance upon recommendation of the Commissioner if the same are to be exported or to be used in the manufacture of other tobacco products on which the excise tax will eventually be paid on the finished product.
>
> On tobacco specially prepared for chewing so as to be unsuitable for use in any other manner, on each kilogram, sixty centavos.
>
> x x x x x x x x x

Petitioner rationalizes, inter alia, that Section 137 broadly grants excise tax exemption for tobacco sold as raw material "by one manufacturer directly to another" without distinction, so it is deemed therefore to refer to all "manufacturers of tobacco products", whether they be manufacturers of cigars, manufacturers of cigarettes or manufacturers of tobacco, and whether or not they are located abroad or in the Philippines. Petitioner then concludes that its importation of stemmed leaf tobacco from other tobacco manufacturers should not be subjected to excise taxes as it falls within the terms of Section 137 of the Tax Code, hence, exempt from excise tax. Respondent opposed this view of the Petitioner and argue that stemmed leaf tobacco is partially prepared tobacco, hence, it falls within the ambit of Section 141(b), thus, subject to an excise tax of ₱0.75 on each kilogram thereof. Further, Respondent invoked Sec. 128, *supra*, in validating its argument that Petitioner's importation of stemmed leaf tobacco is subject to excise tax.

The legal milieu of the instant case is not of first impression. The Court of Appeals has comprehensively addressed itself on the legal issue at bar in the case entitled **Commissioner of Internal Revenue vs. Fortune Tobacco corporation, CA-G.R. SP Nos. 38219 and 40313, dated January 30, 1998, thus,**

> "There is no disputing the fact that stemmed leaf tobacco is not among the tobacco products expressly mentioned in Section 141. The issue, therefore, is whether or not Revenue Regulations No. 17-67 is valid insofar as it interprets the statutory term "partially prepared tobacco" so as to include stemmed leaf tobacco.
>
> It is an elementary principle of Administrative Law that in interpreting or implementing a provision of law, a government agency cannot go beyond the terms and provisions of the basic law. Much less can it go against the law itself. Administrative rules and regulations issued by a particular department or agency must be in harmony with the provision of law and should be for the sole purpose of carrying into effect the statutory

provisions which it is construing or implementing. An administrative agency cannot extend, diminish, or otherwise amend the general provision of law (Fernando Juan vs. Musngi, 155 SCRA 133 [1987]; U.S. vs. Tupasi Molina, 29 Phil. 119; Director of Forestry vs. Muñoz, 23 SCRA 1183 [1968]; Gonzalo Sy vs. Central Bank, 70 SCRA 570 [1976]; Bautista vs. Juinio, 127 SCRA 342 [1984].

There are limitations to the rule making power of administrative agencies. When Congress authorizes an administrative body to promulgate rules and regulations to implement a given legislation, all that is required is that the regulation must not contravene the statute, but must conform to the standards it prescribed (Tayug Rural Bank vs. Central Bank, 146 SCRA 120 [1986]; Del mar vs. Philippine Veterans Administration, 52 SCRA 340 [1973]).

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In case of discrepancy between the basic law and a rule or regulation issued to implement it, the basic law prevails. The regulation cannot go beyond the provisions and terms of the basic law (Shell Philippines Inc. vs. Central Bank, 162 SCRA 628 [1988]).

After a careful study of all aspects of the law and the revenue regulation involved in this case, We come to the conclusion that the Commissioner of Internal Revenue has not engaged in mere interpretation but has gone into unauthorized modification or amendment of the law. Only Congress can do this. Section 2(M)(1) of Revenue Regulations No. 17-67 is, therefore, ultra vires and invalid.

Section 137 of the Tax Code, earlier cited, expressly defines "stemmed leaf tobacco" and excludes it from payment of the tax when sold in bulk as raw material by one manufacturer directly to another. While this particular section provides for removal of tobacco products without prepayment of tax, it is significant that the Tax Code defines and classifies stemmed leaf tobacco under its Section 137. When Revenue Regulations No. 17-67 undertakes to classify stemmed leaf tobacco under Section 141 in a manner different from the way it is treated in Section 137, it is no longer engaged in mere classification. It is already adding something to the law not in consonance with what the law itself specifically provides but contrary to it. It is not only engaged in amendment but in amendment contrary to a specific provision of the same law.

The Petitioner argues that Section 137 is for one tax purpose while Section 141 is for another. The fact is that the reason for one provision is also present in the other and must, therefore, be treated in the same light.

Section 141 of the Tax Code specifically excludes "fine cut shorts and refuse, clippings, cuttings, stems and sweepings of tobacco resulting from the handling or stripping of whole leaf tobacco" from the 75 centavos per kilogram tax when disposed of or sold. The condition in the statute is that the above must be exported or used in the manufacture of other tobacco products. The reason for the exclusion is that the excise tax will eventually be paid on the finished product.

The same reason applies to stemmed leaf tobacco which is intended solely as a raw material in the manufacture of cigarettes and other tobacco products. After the cigarettes are manufactured, excise taxes will be paid. In effect, what the Petitioner has provided in the disputed regulation is double taxation-the payment of excise taxes on the raw material and later, the payment of excise taxes on the manufactured product. Double taxation must be specifically and clearly provided by law. It cannot be imposed by administrative rule-making body. If specifically excluded under the last paragraph of Section 141, taxes cannot be included under paragraph 2 of the same section by a mere interpretation of the Petitioner.

It is elementary that any taxes not specifically imposed by law cannot be mandated on the strength of an administrative regulation which purports to implement the said law. Only Congress, not the BIR, can provide for additional taxes. Revenue Regulations No. 17-67 is correct when it provides for the procedure in enforcing the statute. It can state the rules, taxation-wise, on securing permits, putting up factories and machineries, procuring raw materials, recording production, and disposing of the finished product. But the Petitioner's powers are limited to procedure and implementation and not substantive law which seeks to add new taxes in addition to those specifically taxed under the law. This is especially true when the particular product being taxed in another section of the same law and also in another law. The Petitioner is arrogating powers to itself which it does not possess.

The argument that stemmed leaf tobacco used as raw materials is exempt from taxation only when it is from one L-7 manufacturer to another L-7 manufacturer suffers from the same infirmity. It is based on the BIR's own Revenue Regulations V-39 which add to the law something which is not there. Using its power of classification, the Petitioner has ventured into an amendment and amplification of the basic law.

Section 141 taxes fine cut shorts and refuse, scraps, clippings, stems and sweepings but the unnumbered paragraph after Section 141(c) exempts these items if they are used in the manufacture of other tobacco products on which the excise tax will eventually be paid on the finished product.

The law defines and exempts certain raw materials on condition that excise taxes will eventually be paid on the finished manufactured product. The BIR has classified these raw materials in a restrictive manner-only from one L-7 to another L-7 when all that the law requires is that the excise taxes not collected at the start will eventually be paid once the tobacco product comes out in final form. For a wide variety of raw materials, there is double imposition by the BIR of excise taxes when the law obviously removes taxes at the start of the manufacturing process and imposes them only once-when the process is completed. Again, double taxation is valid but only when it is provided by statute. It cannot be imposed through an interpretative rule.

The Petitioner's contention that the classification of stemmed leaf tobacco as "partially manufactured tobacco" under Revenue

Regulations No. 17-67 prevails over the definition of processed tobacco under Rep. Act 698 is fanciful to say the least. Revenue Regulations No. 17-67 is not a basic law. It is simply an implementation of the statutory provision of the Tax Code. A mere regulation of a quasi-legislative agency cannot prevail over the express definition under a law passed by Congress itself. It is elementary that an administrative regulation cannot amend or repeal the express provisions of statutes enacted by Congress. How can the Petitioner argue that an administrative regulation prevails over a statute or law?

The Petitioner states that Sections 141 and 137 of the Tax Code must be read and construed together. It explains that under Section 141 stemmed leaf tobacco, being partially prepared tobacco is subject to specific tax. However, under Section 137 if the stemmed leaf tobacco is sold in bulk directly from one manufacturer to another in accordance with the conditions prescribed in Section 20(a) of Revenue Regulation No. V-39, it is exempt from specific tax. It is very obvious that it is not the Tax Code which taxes on one hand and exempts from taxes on the other hand the tobacco involved. It is the addition of a definition of, partially manufactured tobacco which clashes with the law itself and the regulatory conditions of BIR which restrict the application of the law to an extremely limited class that form the basis of BIR action. The Petitioner engages in legislation and then uses its own administrative or quasi-legislative powers to add a certain class of tax which is neither expressed nor contemplated in the basic law.

We are aware of the ruling in Commissioner of Internal Revenue vs. La Suerte Cigar and Cigarette Factory, CA-G.R. SP No. 38107 issued on December 29, 1995.

We note, however, that this Court in the case of La Suerte Cigar failed to take into account the limitations in the exercise of quasi-legislative powers by administrative agencies. True, the law in Sections 141 and 137 of the Tax Code contains the phrase "under such conditions as may be prescribed in the regulations of the Department of Finance." However, the power to prescribe regulations is

> not a carte blanche giving the BIR full discretionary authority to add to the law. It is not a roving commission. It is subject to established and basic principles of Administrative Law enunciated in scores of Supreme Court decisions. There is no discrepancy between the principles enunciated in this decision and in the La Suerte decision except that the latter stopped short and did not go into the powers of administrative agencies. If it had gone fully and far enough into the quasi-legislative powers of Bureau of Internal Revenue, it would have arrived at conclusions fully consonant with our findings."

The Petitioner in the instant case, being similarly situated with the aforesaid Fortune Tobacco Corporation ruling, is therefore entitled to the same interpretation. What is left for this Court is the proper determination as to whether or not Petitioner has complied with the evidentiary requirements for the grant of the claimed refund. In consideration therefore of the aforementioned Decision of the Court of Appeals and after a careful and deliberate scrutiny of the testimonial and documentary evidence adduced by Petitioner, (Exhibits "A" to "D") this Court **RESOLVES** to **GRANT** the desired relief.

**IN THE LIGHT OF ALL THE FOREGOING,** Respondent is hereby **ORDERED** to **REFUND** to herein Petitioner the total amount of ₱118,350.00, representing its erroneously paid specific taxes for May, 1995, without pronouncement as to costs.

**SO ORDERED.**

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

AMANCIO Q. SAGA
Associate Judge

# CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge