REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

PIO BARRETTO SONS, INC.,
Petitioner

versus C. T. A. CASE NO. 75

COLLECTOR OF INTERNAL REVENUE,
Respondent.

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

Nov. 8, 1956

D E C I S I O N

In a letter dated December 10, 1954, respondent assessed against petitioner the sum of ₱79,933.41, as forest charges and sales tax, plus the corresponding surcharges. The said amount has been itemized in the memorandum of counsel for respondent, as follows:

1.	Forest charges and surcharges on alleged purchases of logs not accompanied by auxiliary invoices or official receipts certifying payments of forest charges, 1947-1949	₱60,388.46
2.	Forest charges and surcharges on undeclared purchases of logs -	
	1949	4,125.35
	1951	430.06
3.	50% surcharge for discharging without permit, 1948-1949 . .	162.58
4.	Deficiency sales tax and surcharge, 1947-1949	14,826.96
	T o t a l	₱79,933.41

In addition to the said sum of ₱79,933.41, petitioner has also been asked to pay the sums of ₱1,000.00 and ₱200.00 as "penalty in extrajudicial settlement of petitioner's failure to pay the sales tax in violation of sections 183 and 186 of the Tax Code, as penalized in section 209 of the same Code" and for violation of the Bookkeeping Law.

Petitioner received the letter of respondent of December 10, 1954 on January 12, 1955, and has appealed from said decision disclaiming liability for the entire amount. The letter of respondent dated January 10, 1955 relative to the "penalty" of ₱200.00 was received by petitioner on January 15, 1955.
We shall take up each item of the assessment separately.

1. Forest charges and surcharges from 1947 to 1949 in the sum of ₱60,388.46.

This item of ₱60,388.46 has been arrived at as follows:

Regular forest charges on 1,096,111 bd. ft. of first group timber	₱ 9,048.06
Regular forest charges on 409,513 bd. ft. of second group timber	1,931.66
Total regular forest charges	₱10,979.72
300% surcharge for cutting without license	32,939.16
50% surcharge for transporting without invoice	5,489.86
50% surcharge for discharging without permit	5,489.86
50% surcharge for late payment	5,489.86
Total forest charges and surcharges	₱60,388.46

Petitioner claims that the forest products (logs) on which the above forest charges and surcharges have been assessed were all purchased by it; hence, it can not be held liable for the payment of said forest charges and surcharges. On the other hand, respondent claims that while petitioner did not cut and remove the said forest products, the persons who cut the same were its agents. According to respondent -

> "It was ascertained by the investigating agent that the procedure of the petitioner in connection with the alleged purchases of logs in question was to give loans or cash advances to the alleged suppliers and the said loans or cash advances were paid back to the petitioner in the form of logs allegedly by way of sale. (See pp. 5-7 of the report of Agent Celso P. Rezal dated November 11, 1954, Exh. 1; see also t.s.n. pp. 99-100). This procedure was adopted by the petitioner in order to have an adequate supply of logs as required by sawmill operators in Republic Act No. 460 and at the same time be free from paying the forest charges thereon by making it appear that it merely purchased the said logs. <u>However, under the circumstances those alleged suppliers are merely the Agents of the petitioner.</u>" (Page 7, Memorandum for Respondent; underscoring supplied.)

It is admitted that petitioner gave loans or cash advances to certain persons who paid such loans or cash advances in the form of logs. But respondent alleges that the alleged suppliers were merely the agents of petitioner in view of the circumstances of the case. What are those circumstances which justify the conclusion that the said suppliers of logs were the agents of petitioner?

The circumstances mentioned by respondent in justifying his conclusion that the suppliers of logs were agents of petitioner are (1) that "the majority of the vouchers supporting the alleged purchases were not accompanied by the auxiliary or official invoices or official receipts showing payment of the forest charges on the logs purchased, contrary to the provisions of section 11 of Regulations No. 85", and (2) that "the vouchers supporting the alleged purchases of logs lack adequate information and identification of the payees appearing therein." (Page 6, Memorandum for Respondent.) From these circumstances, respondent has arrived at the following conclusion:

> "The foregoing facts ascertained by the investigating agent show that the petitioner either cut the logs in question or caused the cutting thereof and that the forest charges thereon were not paid. The facts also show that the petitioner is not a forest licensee and, therefore, the logs in question were cut or caused to be cut by the petitioner without license, a fact which makes it liable for the 300% surcharge as prescribed in section 267 of the Tax Code. Likewise, it is liable for the payment of the 50% surcharge for transporting without invoice, 50% surcharge for discharging without permit, and 50% surcharge for late payment of the forest charges, as prescribed in section 267. At this juncture, it may be stated that the said surcharges of 50% were reduced to 25% by virtue of Republic Act No. 434 which took effect only on June 7, 1950." (Pp. 8-9, Memorandum for Respondent.)

Petitioner is sought to be held liable for the forest charges and surcharges on logs that it purchased from 1947 to 1949 under Sections 264 and 267 of the National Internal Revenue Code, which read as follows:

> "SEC. 264. Charges on timber cut in public forests.—Except as otherwise specially provided, the following charges shall be collected on each cubic meter of timber cut in any public forest or forest reserve in the Philippines, whether removed therefrom or not:
>
> "(a) On timber in the first group, not including ebony, camagon and molave stripped of sapwood, three pesos and fifty centavos.
>
> "(b) On ebony stripped of sapwood, six pesos.
>
> "(c) On camagon stripped of sapwood, five pesos.
>
> "(d) On molave stripped of sapwood, four pesos.
>
> "(e) On timber in the second group, two pesos.
>
> "(f) On timber in third group, not including firewood, one peso and twenty centavos.
>
> "(g) On timber in the fourth group, not including firewood, sixty centavos."
>
> "SEC. 267. Surcharges for illegal cutting and removal of forest products or for delinquency.—Where forest products are unlawfully cut or gathered in any public forest without license or, if under license, in violation of the terms thereof, the charges on such products shall be increased by three hundred *per centum*. If forest products shall be removed without invoice, or upon removal, shall be discharged without permit from boat, car, cart, or other means of transportation, the charges shall be increased by twenty-five *per centum*, and if, in any case, the proper charges upon forest products are not paid within sixty days after the same shall be due and payable, such charges shall be increased by twenty-five *per centum*: *Provided, however*, That the Collector of Internal Revenue may, in meritorious cases, waive the surcharge of fifty *per cen-*

> tum for discharging without permit or grant an extension of time not exceeding thirty days for the payment of the forest charges without surcharge. (As amended by Republic Act No. 434.)"

Section 264 classifies timber into various groups and imposes different rates of charges on each group cut in any public forest or forest reserve. Section 267 prescribes the penalties for cutting or gathering forest products in any public forest without license or, if under license, in violation of the terms thereof; for removing forest products from the cutting area without invoice; for discharging forest products at destination without permit; and for late payment if the forest charges are not paid within the period prescribed in Section 273.

It is apparent from Sections 264 and 267 that the person who cuts or gathers timber from the forest is the one liable for the payment of forest charges. The same is true with respect to other forest products.] Section 265 imposes forest charges on firewood cut in public forests or forest reserves; Section 266 provides for the payment of forest charges on all forest products cut, gathered and removed from any private land the title to which is not registered with the Director of Forestry; Section 268 prescribes forest charges on timber cut for use in the development of a mining claim; and Sections 269 and 270 provide for payment of forest charges on minor forest products gathered or removed from any public forest or forest reserve. That the person who cuts, gathers or removes forest products from the public forests is the one liable for the forest charges is also evident from Section 273 which prescribes the time of payment of such charges. That section provides that forest charges shall be payable at the time of the removal of the same from the forest.

We are, therefore, of the opinion that, under existing law (Secs. 262-273, Revenue Code), forest charges are payable primarily by the person who cuts, gathers or removes forest products from the public forests or forest reserves. Petitioner is admittedly not the one who cut, gathered or removed the logs in question from the public forests.

But it is argued that the persons who allegedly supplied petitioner with the logs in question were merely the agents of the latter so that it is the one liable for the payment of the forest charges and the corresponding penalties. The facts of record do not support the conclusion arrived at by respondent. In the very words of Agent Celso P. Razal of the Bureau of Internal Revenue:

> "It was also ascertained in the investigation that <u>the company buys its logs it manufactures into lumber from public land concessionaires and from private woodland owners throughout the Philippines.</u>" (Page 4, Report of Agent Razal, Exh. 1, page 58, B. I. R. Records; underscoring supplied.)

Agent Razal explained the nature of said transactions as follows:

"Moreover, due to business necessity, to have a ready supply of raw materials in the form of logs, the taxpayer admitted that they resorted to making contracts with individuals to supply them with logs. Their actual practice was to give cash advances to these suppliers as manifested by notes receivables with the stipulation that the said loan shall be paid in logs with the name of the timber duly specified. This practice was obviously one of the reasons for their failure to have auxiliary invoices, 'guias' or commercial invoices and/or official receipts signifying payment of forest charges to support their vouchers and also their possible connivance with the illegal traffic or cutting of forest product. To the instant taxpayer, a supplier bringing logs in payment of his note payable regardless of the nature and circumstance of the shipment relative to compliance or noncompliance with Internal Revenue laws and regulations will always be accepted and welcomed by them. Their prime concern is to collect from the supplier the amount receivable in the form of logs and to have a ready supply of the raw materials for business necessity. Samples of cash vouchers supported with note receivables were taken by the undersigned for reference." (Pp. 6-7, Report of Agent Razal, Exh. 1, pp. 55-56, B.I.R. Records.)

If petitioner merely bought from its suppliers the logs that it manufactured into lumber, as admitted by Agent Razal and confirmed by respondent himself, certainly no agency relationship was created between the parties. What was created was the relationship of creditor and debtor in the first instance, and when logs were delivered, that of buyer and seller. We can not see how petitioner can be held liable, under the circumstances, for the payment of the forest charges on the logs that it bought, no evidence having been adduced that it cut or removed said logs from any public forest. The mere absence of auxiliary invoices or "guias" does not give rise to the presumption that petitioner caused or ordered to be cut the logs in question in the face of the admission by respondent himself that petitioner purchased said logs "from public land concessionaires and private woodland owners throughout the Philippines."

Moreover, petitioner is being charged with cutting, or ordering or causing to be cut, forest products without license, which carries with it the imposition of a penalty by way of surcharge in the amount of 300% of the forest charges due on the forest products illegally cut. No person may be penalized upon mere presumptions not supported by clear and convincing evidence of the commission of the prohibited act. That no auxiliary invoice or "guia" accompanied a purchase invoice covering forest products is no evidence that the said forest products were illegally cut and that the purchaser is guilty thereof. Much more than the failure to present auxiliary invoice or "guia" is necessary to prove that a supposed buyer of forest products is not in fact a "buyer" but an "illegal cutter" of such forest products to warrant the imposition of the heavy penalty of 300% of the forest charges due. Respondent has miserably failed to present such evidence; on the contrary, the evidence of record shows beyond doubt that petitioner was merely the purchaser of said logs.

So much stress has been placed by respondent upon Section 13 of Regulations No. 85 of the Department of Finance, which provides:

> "SEC. 13. Payment of charges on forest products taken without license. - The possessor of forest products cut or gathered without license on which charges are payable is required to present auxiliary invoices. The procedure outlined in section 11 of these regulations shall then be followed. Surcharges shall be collected for cutting without license, for cutting in violation of the terms of the license, transporting without invoice, or discharging without permit."

The position taken by respondent is that since this section of Regulations No. 85 "specifically requires the payment of forest charges by the possessor of forest products cut, gathered, or removed without license," any person in possession of such forest products, whether or not he was the one who cut, gathered or removed the same from the public forests, is liable for the payment of such charges. This is a too literal interpretation of the regulations which finds no sanction under the law.

As already adverted to above, the law requires payment of forest charges by the person who cuts, gathers or removes forest products from the public forests or forest reserves. The "possessor of forest products cut or gathered without license" mentioned in Section 13 of Regulations No. 85 obviously refers to the person who cut or gathered the forest products, and not to a subsequent possessor or transferee for value, otherwise the said provision of the regulations would be invalid for being contrary to law. Furthermore, the said section of Regulations No. 85 requires that surcharges shall be collected "for cutting without license, for cutting in violation of the terms of the license," etc., which penalty can not certainly be imposed upon a person who did not cut such forest products. To construe said section as authorizing the imposition of the penalty for illegal cutting of forest products upon a person who did not cut the same would be violative of the constitutional guarantee that no person may be deprived of his life, liberty or property without due process of law.

Let us view the case from another angle. May a purchaser for value of forest products be held personally liable for the forest charges?

Forest products may be cut and removed from the public forests only upon licenses issued by the Director of Forestry. The issuance of licenses by the Director of Forestry is in the nature of sales of forest products to the licensees at the prices specified in the National Internal Revenue Code or as otherwise determined in accordance with law. (See Sec. 1830, Administrative Code.) For this reason, the Tax Commission which recommended the enactment of the National Internal Revenue Code in 1939 expressed the view that -

> "Forest charges are to be distinguished from taxes. They are,

strictly speaking, the price which the Government charges for the privilege granted to concessionaires to exploit the public domain, rather than a tax imposed to support the general services of government." (Vol. I, Report of the Tax Commission/[1939], p. 90; see also page 8, Memorandum for Respondent.)

For the protection and conservation of the public forests, the utilization of which is expressly limited by the Constitution to citizens of the Philippines (Art. XIII, Sec. 1 of the Constitution), the Tax Commission recommended that the surcharge or penalty for cutting forest products without license or in violation of the terms of the license be increased from 100% (Sec. 1514, Adm. Code) to 300% of the regular charges due. This recommendation was adopted by Congress in Section 267 of the Revenue Code.

But while the forest charges imposed in Chapter V, Title VIII (Secs. 262-273) of the Revenue Code are in the nature of prices for the sale of forest products, Congress has seen fit to maintain the classification of forest charges as national internal revenue taxes. (Section 18, National Internal Revenue Code; formerly Section 1438, Adm. Code.) Being an internal revenue tax, the collection of forest charges is enforceable only in the same manner as other internal revenue taxes. (Op. Atty. Gen., Oct. 27, 1922.)

Under Section 315 of the Revenue Code (formerly Sec. 1588, Adm. Code), the Government has a lien on forest products on which the corresponding forest charges and surcharges have not been paid. This lien attaches to the forest products and may be enforced against such forest products in the hands of subsequent possessors but not against innocent purchasers. "Where a statute makes taxes on personal property a lien thereon, a purchaser of such property takes the same free from any lien for taxes if the title passes before such a lien attaches by levy, distraint, or otherwise. (Shelby vs. Tiddy, 1896, 118 N. C., 792)." (Hongkong & Shanghai Banking Corporation v. Rafferty, 39 Phil., 145, 151.)

It may be argued that petitioner herein can not be considered as an innocent purchaser of the logs in question because of its failure to produce auxiliary invoices or "guias" covering its purchases of said logs. Granting that petitioner was not an innocent purchaser which has not been clearly established, yet we are of the opinion that the collection of the forest charges and surcharges here involved can not be enforced against petitioner personally. The lien, if it exists, may be enforced only as against the property to which it has attached. As aptly stated in the case of Hongkong & Shanghai Banking Corporation v. Rafferty, supra, "the plaintiff (the purchaser of the forest products) was not of course personally liable for any part of the internal revenue taxes due the Government from Pujalte & Co. (the seller)." Therefore, if the property subject to the lien no longer exists, as in the instant case, the logs purchased and manufactured into lumber having been sold by petitioner, the lien is thereby lost and the remedy of the Government is to proceed against the person or persons primarily liable for the payment of the tax obligation, in accordance with Sections 316-330 of the Revenue Code. This principle has been recognized and adopted in Regulations No. 85 of the Department of Finance, Section 43 of which provides:

> "In case the products have already been removed and are beyond recovery, or have become valueless, the collection of the regular forest charges and surcharges due thereon shall be enforced by distraint and levy in accordance with sections 1588-1601 of the Administrative Code (Now Sections 315-330, Revenue Code)."

There is another important aspect of the case which apparently has been overlooked by respondent which to our mind militates against the legality of the assessment. Agent Razal, in his report of November 11, 1954 (Exh. 1 of Respondent) found as a fact "that the company buys its logs it manufactures into lumber from public land concessionaires and from private woodland owners throughout the Philippines." No evidence has been adduced to show that the public land concessionaires and private woodland owners referred to did not have licenses to cut forest products from their public land concessions and private woodlands. The failure of respondent to produce such evidence is specially significant as regards owners of private woodlands or forest lands.

In the case of private woodlands, forest products cut and removed therefrom are not subject to forest charges, if said lands are registered with the Director of Forestry in accordance with the Forest Law and regulations. (Sec.1829, Adm. Code; Sec. 266, Revenue Code; Sec. 15 [a], Regulations No. 85.) The reason for this is obvious. The Government can not sell forest products which it does not own. (Sec. 1830, Adm. Code.) The registration is required as a condition for exemption to prove private ownership of such woodlands. Where the woodland or forest land is not registered, either because the supposed owner can not establish a valid title thereto or for any other reason, the owner is required to secure a license from the Director of Forestry to cut forest products from his land. A license once secured entitles the owner of the private land to cut timber and other forest products from said land without the necessity of paying forest charges. In other words, the license issued by the Director of Forestry to the owner of a private woodland in accordance with the Forest Law and regulations has the same force and effect as the registration of said land with the Director of Forestry. If the owner of the private woodland fails to secure such license, he is liable to the corresponding charges as in the case of forest products cut from the public forests. (See Sec. 266, Rev. Code; Sec.15, Regs. No. 85.)

Respondent not having shown that the owners of private woodlands who supplied logs to petitioners either did not register their private woodlands with the Bureau of Forestry or did not have licenses to cut forest products therefrom, the assessment against petitioner for forest charges and the imposition of the penalties for illegal cutting of such logs is fatally defective.

2. Forest charges and surcharges on undeclared purchases of logs in 1949 and 1951 in the sums of ₱4,125.35 and ₱430.06.

This item of the assessment is in the nature of a deficiency assessment of forest charges and surcharges in connection with what respondent calls undeclared purchases of logs. Inasmuch as respondent himself admits that the said sums of ₱4,125.35 and ₱430.06 are being assessed against petitioner on account of logs that it purchased, the assessment can not be sustained as in the case of the first item.

3. 50% surcharge for discharging without permit in the sum of ₱162.58.

Respondent seeks to collect from petitioner the sum of ₱162.58, representing 50% surcharge for discharging without permit certain shipments of logs in 1948 and 1949. Petitioner claims that, as purchaser, it was under no obligation to secure the discharge permits, even granting that no such permits were in fact secured. Says petitioner, through its counsel:

> "It is quite clear that the timber covered by these invoices are admitted by the respondent to have been purchased by the petitioner. It is equally admitted that the timber

covered by these invoices were properly cut under license and properly transported; the only claim of the respondent is that the discharge was not proper. On the basis of the admitted facts that this timber was cut properly under license and transported properly under auxiliary invoice, it would seem that the petitioner had no intervention at all in this timber until it purchased the same. As such purchaser, it certainly would not have the obligation to discharge the timber, for the discharging of the timber is a part of tradition which pertains to the vendor. And since it is quite clear that the act of discharging, improper or otherwise, was not done by the petitioner, the surcharge therefor should not be borne by the petitioner." (Pp. 42-43, Memorandum for the Petitioner.)

On the other hand, respondent claims that "since the herein petitioner appears to be the consignee of the logs involved in this particular item of the assessment, the 50% surcharge for removal without discharge permit as prescribed in section 267 of the Tax Code is due and collectible." (Page 15, Memorandum for the Respondent.)

It is admitted by respondent that the duty of securing a discharge permit for forest products transported from the point of origin to the place of destination devolves upon the licensee (forest concessionaire) or his agent. However, he alleges that taking into consideration Section 17(a) of Regulations No. 85 which provides -

"x x x The deputy provincial treasurer shall then grant a permit to discharge the forest products by accomplishing the form printed at the bottom of the official invoice and return the official invoice to the consignee for his protection and as

> authority to discharge the forest products. When the shipment consists of timber, one copy of the auxiliary invoice with the date of the discharge permit noted thereon in the proper place will be returned to the consignee, together with the official invoice. x x x"

in relation to Section 22 of said Regulations, "the duty to secure discharge permit devolves also upon the consignee and if the consignee receives delivery of forest products without discharge permit he stands liable for discharging without permit."

The obligation of the consignee of forest products to secure a discharge permit at the point of destination may be admitted. Petitioner claims that it was not the consignee but only the purchaser, and that it received the logs from the vendors after their discharge by the carrier. Counsel for respondent have not called our attention to any piece of evidence to show that petitioner was in fact the consignee of the logs in question. They merely stated in their memorandum that "the herein petitioner appears to be the consignee of the logs involved in this particular assessment."

It should be borne in mind that the surcharges provided in Section 267 of the Revenue Code are penalties imposed for offenses committed in connection with cutting and removing of forest products and in the payment of forest charges. (See Op. Atty. Gen., Nov. 14, 1922.) As such, there must be clear and convincing evidence to prove the commission of the offense to justify the imposition of the corresponding penalty. The statement of counsel for respondent that petitioner appears to be the consignee deserves but slight consideration.

Granting, arguendo, that petitioner was the consignee, it has been satisfactorily proven that discharge permits were secured from and granted by agents or inspectors of the Bureau of Internal Revenue, as shown by the testimony of Agent Razal, whose report (Exh. 1) is the only basis of the assessment in this case.

> Q. Will you examine Exhibit "5" together with itssblank marked Exhibit "5-A" . . . is this a representative of those 22 vouchers which you say does not show the discharge permit?
>
> A. (Witness examines Exhibits "5" and "5-A")
>
> Yes, sir.
>
> Q. In classifying this Exhibit "5" as an auxiliary invoice which shows no discharge permit . . . did you know this writing on the face of Exhibit "5" which says "Cancelled this date 9/23/48 all transported" with an illegible signature?
>
> A I did not.
>
> ATTY. CAPARAS:
>
> For purpose of identification, we request that this notation appearing on the face of Exhibit "5" for respondent be enclosed in red pencil and marked as Exhibit "F" for the petitioner in this case.
>
> Q. Did you not inquire from your office as to who can have signed this notation marked Exhibit "F"?
>
> A I did not.
>
> Q. Did you not notice at the time of your inspection that the date when the notation was made as to the

transportation of the logs in question is substantially the same as the date of the auxiliary invoice. . .the notation "Cancelled this date September 23, 1948" whereas, the auxiliary invoice was dated September 22, same year . . .did you notice that?

A. I did not notice it before.

Q. So this auxiliary invoice dated May 3, 1949 which, for purposes of identification, we ask that it be marked Exhibit "G" for the petitioner in this case, is another of those auxiliary invoices which you say show the improper discharge without permit?

A. (Witness examines Exhibit "G")

Yes, sir.

Q. In classifying this invoice as such, did you note the appearance of the markings on the face of Exhibit "G" which says: "Inspected and verified 5/4/49 Angeles"?

A. I made no reference on this and I did not notice this (referring to notation on Exhibit "G") because I only referred to the unaccompanied form of auxiliary invoice for the purpose of securing discharge permit as required under Regulation No. 85.

ATTY. CAPARAS:

For purposes of identification, I request that the notation "Inspected and verified 5/4/49 Angeles" be enclosed with red pencil and marked as Exhibit "G-1" for petitioner in this case.

Q. Do you know if this fellow "Angeles" whose signature appears as part of Exhibit "G-1" was one of the former agents of the Bureau of Internal Revenue in charge of looking into discharge permit of persons transporting logs to Manila?"

A. I would not know that because, as I said, I have not referred to the markings.

Q. You said you have not referred to this before and that your attention to the notation was not called . . . would you say the classification of Exhibit "G" here as evidencing improper discharge without permit?

A. Off-hand, I could not say that these markings would signify an accomplishment form describing the prescribed discharge permit on auxiliary invoice. And before I would commit to any proposition, I would first verify these markings before the signing person here, whether such signature and markings would eventually be considered as discharge permit of this particular invoice.

Q. But, as a matter of fact, at the time you conducted this case, you did not inquire as to who was that person signing . . . is it not?

A. Yes, sir, because I have not referred to the markings. I only referred to the unaccomplished form of discharge permit.

Q. Do you know the practice of the Bureau of Internal Revenue regarding the issuance of this permit?

A. No, sir.

Agent Razal confessed his ignorance as to the manner or procedure of granting discharge permits. He admitted that he did not check the signatures or initials appearing in the auxiliary invoices showing that the shipments of forest products covered by said invoices were verified and checked by agents or inspectors of the Bureau of Internal Revenue. When confronted with the signature of Angeles (a former forestry inspector of the Bureau of Internal Revenue) in one of the invoices, he merely said:

"I would not know that because, as I said, I have not referred to the markings." And yet the report of Agent Razal, which obviously lacks essential details for the proper determination of the liability of herein petitioner, was accepted at face value by respondent. We can not look with favor upon half-hazard investigations of this character where investigating agents conveniently overlook or disregard essential details to suit their own purposes.

4. Deficiency sales tax and surcharge in the sum of ₱14,826.96 for the period from 1947 to 1949.

The assessment of deficiency sales tax and surcharge against petitioner in the sum of ₱14,826.96 covering the period from 1947 to 1949 is based on the allowance of the value of the logs purchased as a deduction from the gross selling price of lumber manufactured out of said logs. The position taken by respondent on this matter is as follows:

> "x x x As ascertained by the investigating agent, the petitioner allegedly purchased logs but said alleged purchases were not supported by the required auxiliary or official invoices or official receipts showing payment of the forest charges. Under said circumstances, it is evident that the said logs were illegally secured, and having been illegally secured, the sales tax has not been paid on the alleged sales of those logs. Furthermore, there was no evidence presented in court to show that the sales tax on the alleged sales of logs has been duly paid. The petitioner, however, for sales tax purposes, deducted the cost of the said logs from its gross selling price of lumber and paid the

sales tax on its sales of lumber only on the balance.

"Section 186 of the Tax Code allows the deduction, for sales tax purposes, of the cost of the raw materials (logs in this particular case) from the gross selling price of the finished products (lumber in this particular case) only when the sales tax has been previously paid on the raw materials (logs in this particular case) x x x" (Pp. 16-17, Memorandum for the Respondent.)

In short, respondent is of the opinion that for the value of the raw materials to be deductible from the gross selling price of the manufactured articles it is essential that the "sales tax has been previously paid on the raw materials" and that the manufacturer must prove that the sales tax has been actually paid. We do not think that this is the correct interpretation of the law. Parenthetically, we even doubt whether respondent has given the matter serious thought because we know that no manufacturer has ever been required to prove that the sales tax had been previously paid on the raw materials purchased locally from another manufacturer, producer or importer before he is allowed to deduct the value of such raw materials from the gross selling price of his manufactured articles. The case of petitioner is an eloquent proof of this statement. Has respondent required petitioner to prove previous payment of the sales tax on all sales of logs to it by its suppliers before allowing the deduction of the value of such logs from the gross selling price of its lumber? Certainly not. In the assessment of the deficiency sales tax in this case, respondent has taken into account only the purchases of logs involved in the first item, already discussed above, while the value of the logs purchased in other instances has been allowed as a deduction from its gross selling price of manufactured lumber without proof of previous payment of the sales tax on the sales of such logs to petitioner. But this is beside the point. We shall consider the question purely on its merits.

The provision of Section 186 of the Revenue Code involved in this case reads -

> "x x x 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 x.x x."

Section 186 imposes a percentage tax on original sales of articles, not enumerated in Sections 184 and 185, by manufacturers and producers, such tax to be based on the gross selling price or gross value in money of the manufactured articles. From the gross selling price, the law allows to be deducted the total cost of raw materials, as duly established, to arrive at the taxable gross selling price. For the cost of the raw materials to be deductible from the gross selling price of the manufactured articles, the law requires:

(1) That the raw materials

must be subject to tax under Section 186; and

(2) That the total cost of such raw materials must be duly established.

Has petitioner met these requirements? We believe so.

The logs in question were admittedly purchased by petitioner from "public land concessionaires and from private woodland owners." The said logs were used in the manufacture of lumber for sale, and were actually sold. Public land concessionaires and private woodland owners are producers of the logs cut or gathered by them whether from public land concessions or from private woodlands. Consequently, they are subject to tax on their sales of such logs to petitioner under Section 186, logs not falling under any of the classes of articles enumerated in Sections 184 and 185. Also, the total cost of such logs has been duly established, as evidenced by the fact that respondent has assessed a deficiency sales tax on the cost of such logs. These circumstances are sufficient to establish the deductibility of the cost of the logs from the gross selling price of lumber manufactured out of such logs.

Nowhere in Section 186 may be found any provision requiring proof of previous payment of the sales tax on the raw materials before the cost thereof may be allowed as a deduction from the gross selling price of the manufactured articles. To require proof of previous payment of the sales tax on the raw materials by the vendors thereof would constitute an unreasonable requirement which finds no justification in law. To illustrate:

> (1). A, a manufacturer of furniture, bought lumber from B, a sawmill operator, on January 15, 1954. A made furniture out of said lumber and sold the furniture in March, 1954.

Under the law, A is required to file his return of his sales of furniture from January to March, 1954 and to pay the sales tax thereon not later than April 20, 1954. B is also required to file his return of his sales of lumber from January to March, 1954 and to pay the sales tax thereon not later than April 20, 1954. (Section 183, Revenue Code.) Must A prove first that B paid the sales tax on the lumber that he bought from the latter to enable him to deduct the cost thereof from the taxable gross selling price of furniture? And what evidence would be required by the Collector of Internal Revenue to prove payment of the sales tax on said lumber? Would it be the official receipt or a certification by the collecting officer?

Another illustration:

> (2). A, a manufacturer of doors and windows, bought lumber from B, a lumber dealer, who in turn bought the lumber from C, a sawmill operator.

In this case, C is subject to the sales tax on lumber sold to B. B is not subject to the sales tax on his resale of lumber to A, being merely subject to the graduated fixed annual tax under Section 182 of the Revenue Code. A is subject to the sales tax on his sales of doors and windows. What evidence would be required of A to prove payment of the sales tax on the lumber that he bought from B? Would A be required to get a certificate from B as to payment of the sales tax? In all likelihood, B would not be in a position to certify to the payment of the sales tax as he was not the one who paid. On the other hand, A can not ask C to give him such a certificate as he did not buy the lumber from C. In such a case, if the theory of respondent is to be believed, A would not be entitled to deduct the cost of the lumber from his gross sales of doors and windows, which is contrary to the letter and spirit of Section 186.

Another example:

> (3). Suppose in Example (1) B failed to pay the sales tax on his sales of lumber for one reason or another. He paid the sales tax after two years when an agent of the Bureau of Internal Revenue apprehended B for failure to file his sales tax return and to pay the tax.

In this case, must A wait until after B had paid the tax to entitle him to deduct the cost of the lumber from his gross sales of furniture? To follow the theory of respondent would be unduly harsh upon A.

We have given the above illustrations to prove the unreasonableness of respondent's theory. It would cause manufacturers unnecessary difficulties and hamper the flow of business. It is our opinion that where a manufacturer of articles taxable under Section 186 buys raw materials locally, it is enough for him to show that the materials bought by him and used in the manufacture of articles sold is subject to tax under the same section and that the total cost thereof is duly established. If the Collector of Internal Revenue has reason to believe that the sales tax on the raw materials has not been paid, it is his duty to go after the delinquent taxpayer. In the instant case, what respondent should have done is to investigate the vendors of the logs to determine whether or not they have paid the sales tax.

Petitioner has also raised the issue of prescription. It is claimed that the power of respondent to assess taxes against petitioner for the years prior to January 12, 1950 has expired. The assessment in this case was received by petitioner on January 12, 1955. Respondent alleges that petitioner has not presented evidence to sustain the defense of prescription.

The deficiency sales tax has been assessed against petitioner in connection with the total cost of logs deducted from its gross sales of manufactured lumber. It can not be denied, therefore, that petitioner filed its sales tax returns and they were filed on time. Respondent could not have assessed a deficiency sales tax in respect of the cost of logs deducted from petitioner's gross sales if no returns were filed. Said Agent Razal in his report (Exhibit 1 for respondent):

> "Evidently, no sales tax was also paid on the logs and timber illegally secured. Nevertheless, the cost of the logs acquired was deducted from the gross sales of manufactured lumber in computing the amount subject to the sales tax beginning May 1, 1947 (and ending July 25, 1949), in accordance with General Circular V-32." (Page 55, B. I. R. Records; underscoring supplied.)

Counsel for respondent claim that the law applicable to the case is Section 332 of the Revenue Code which authorizes respondent to assess the tax within 10 years from the date of the discovery of the fraud committed by petitioner. They say that petitioner is guilty of fraud because it deducted the cost of the logs from its sales of lumber "notwithstanding the fact that the logs in question were not previously subjected to the sales tax." We quote from the memorandum of counsel for respondent:

> "It may also be stated that the fact that petitioner deducted, for sales tax purposes, the cost of logs from its gross sales of lumber, notwithstanding the fact that the logs in question were not previously subjected to the sales tax, is a showing of fraud. Consequently, the respondent has, under Section 332 of the Tax Code, ten (10) years from the discovery of the falsity, fraud or omission within which to assess the taxes in question. The records show that the facts upon which the assessment in this case is based were discovered sometime on November 11, 1954 (Exh. 1) and the assessment was issued on December 10, 1954 (Exh. 2), well within the period prescribed in section 332 of the Tax Code." (Pp. 18-19,

Memorandum for Respondent.)

Counsel for respondent have apparently taken a stand diametrically opposed to that of respondent in this case. The assessment of respondent as contained in his letter of December 10, 1954 (admitted to have been received by petitioner on Jan. 12, 1955) has imposed upon petitioner only the ordinary surcharge of 25% for late payment. In cases of fraud in the filing of percentage tax returns, Section 183 imposes, and respondent has invariably added to the tax or deficiency tax, a surcharge of 50%. That the fraud penalty of 50% surcharge is not sought to be collected from petitioner is an admission that respondent himself does not believe that the former is guilty of fraud. (See Central Azucarera de Tarlac v. Collector of Int. Rev., C. T. A. No. 206, Oct. 15, 1956.) Counsel for respondent have not made any allegation or representation that respondent committed a mistake in not seeking to collect the fraud penalty. We are, therefore, of the opinion that the statute of limitations properly applicable to this case is Section 331, which authorizes the Collector of Internal Revenue to assess internal revenue taxes only within 5 years after the return was filed. Since the returns in this case, covering transactions which took place from May 1, 1947 to July 25, 1949, were filed more than 5 years before the assessment was received by petitioner on Jan. 12, 1955, the right to assess said deficiency sales tax has prescribed, assuming that the stand of respondent as regards the disallowance of the deduction of the cost of the logs from the gross selling price of lumber is proper.

With respect to the "compromise penalty" in the sums of ₱1,000 and ₱200, we reiterate the opinion expressed in numerous cases already decided by this Court (notably Soledad R. Briñas v. Collector of Internal Revenue, C. T. A. No. 16, Sept. 14, 1955; University of Sto. Tomas v. Collector of Internal Rev., C. T. A. No. 10, September 10, 1956) to the effect that the Collector of Internal Revenue has no power to impose penalties in the guise of compromise without the consent of the taxpayers.

FOR THE FOREGOING CONSIDERATIONS, the decision appealed from is reversed, without pronouncement as to costs.

SO ORDERED.

Manila, November 8, 1956.

ROMAN M. UMALI
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

AUGUSTO M. LUCIANO
Associate Judge