REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

TALISAY-BACOLOD DISTILLING
CO., INC.,
Petitioner,

- versus - C. T. A. CASE NO. 1972

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

10/17/74

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D E C I S I O N

From checks issued by petitioner Talisay-Bacolod Distilling Co., Inc., in favor of Associated Sugar, Inc. and Alfredo T. Garcia in the aggregate amount of ₱19,250.00 as evidenced by four vouchers which authorized advances for purchases of molasses and the corresponding entries in the Molasses Inventory Ledger and the Check Register of petitioner as purchases of molasses respondent Commissioner of Internal Revenue drew the conclusion that the molasses for which the advances were extended were actually delivered and distilled into alcohol. Pursuant to Section 150, in relation to Section 133, of the Revenue Code, respondent assessed against petitioner the sum of ₱152,803.70 as specific tax due on the distilled spirits that were presumptively produced out of molasses then worth ₱19,250.00. Upon refusal of respondent to have the assessment reconsidered, the case is now before this Court for review.

Petitioner is a corporation duly organized under the laws of the Philippines with principal office at the Araneta Enterprises Building, Cubao, Quezon City. It is engaged in business as distiller, rectifier and denaturer of alcohol. Its supply of molasses, which is the raw material used in the production of rectified alcohol, is secured from different planters and sugar centrals, namely: Talisay-Silay Milling Co., one of the stockholders of petitioner; Ma-ao Sugar Central; and Bacolod-Murcia Sugar Central, another stockholder of petitioner, which are all located in Negros Occidental.

Sometime in 1962, by virtue of authority No. 129 issued on June 1, 1962, an investigation was conducted by BIR Examiners Ernesto de Guia and Manuel Jardiel of the books and accounting records of petitioner for purposes of the specific and percentage taxes due from petitioner for the fiscal years 1957-1958, 1958-1959 and 1959-1960. The examiners found and reported that for the fiscal year 1959-1960, the total quantity of molasses purchased and received by the distillery, as disclosed by the raw material account, which a distillery keeps pursuant to Section 150, in relation to Section 133, of the Revenue Code, was 304,877 gallons only. However, the Ledger Account (Molasses Inventory - No. 103) of petitioner carries the following entries:

November 30, 1959 - Molasses purchased - ₱18,000.00

December 31, 1959 - Molasses purchases - ₱1,250.00

Tracing the said entries to the original entry in the journal of the Check Register (Disbursement Book), the examiners found that:

(a) That on November 4, 1959, check No. A-86607 of the Bank of the PI for ₱12,000.00 was issued by the Talisay-Bacolod Distilling Co., Inc. in favor of Associated Sugar Inc. in payment of molasses purchased and charged to "Account No. 103".

(b) That on November 16, 1959, check No. A-86614 of the Bank of the PI for ₱5,000.00 was issued by the Talisay-Bacolod Distilling Co., Inc. in favor of Associated Sugar Inc. in payment of molasses purchased and also charged to "Account No. 103".

(c) That on November 11, 1959, check No. A-86616 of the Bank of the PI for ₱1,000.00 was issued by the Talisay-Bacolod Distilling Co., Inc. in favor of Associated Sugar Inc. in payment of molasses purchased also charged to "Account No. 103".

(d) That on December 15, 1959, check No. A-96009 of the Bank of the PI for ₱1,250.00 was issued by the Talisay-Bacolod Distilling Co., Inc. in favor of Mr. Alfredo T. Garcia in payment of molasses purchased also charged to "Account No. 103". (Exh. "P", pp. 26-30, BIR rec.; Exh. "A", page 25, BIR rec.)

The molasses with an aggregate purchase price of ₱19,250.00 would correspond to 76,998.6 gallons. Since 76,998.6 gallons of molasses were not reflected in the raw material account of petitioner for the fiscal year 1959-1960, the Bureau of Internal Revenue examiners reported that instead of a summary of 304,877 gallons only, the raw material account and should have 381,875.6 gallons. On the basis of these findings, respondent's examiners drew the conclusion that the 76,998.6 gallons of molasses were actually received and distilled by petitioner for which the specific tax amounting to ₱152,803.70 was not paid.

Parenthetically, it may be stated that petitioner does not dispute the computation of the alleged specific tax of ₱152,803.70. However, based on the records of petitioner which show that for every gallon of molasses 1½ liters of distilled spirits at 189% is produced, it follows that out of the 76,998.6 gallons of molasses, 115,497.6 gauge liters, or an equivalent of 218.291 proof liters of distilled spirits could be produced. So that pursuant to Section 150, in relation to Section 133, of the Revenue Code, the sum of ₱152,803.70 would be the specific tax due on 218,291 proof liters of distilled spirits which could be produced out of 76,998.6 gallons of molasses.

Based on this report of his examiners, respondent Commissioner of Internal Revenue assessed on April 3, 1963 against petitioner the sum of ₱152,803.70 as deficiency specific tax for the fiscal year ended October 31, 1960, plus a compromise penalty of ₱300.00.

What next transpired between the parties may be briefly summarized as follows:

1. On June 1, 1963, Mr. Arsenio Yulo, resident manager of petitioner, wrote the Bureau of Internal Revenue stating that the entries made in the ledger concerning purchases of molasses made on November 30, 1959 and December 31, 1959 in the amounts of ₱18,000.00 and ₱1,250.00, respectively, upon which the assessment was based were not actual purchases but only advances to the Associated Sugar, Inc. and to Mr. Alfredo Garcia for the purchase of molasses.

2. On June 6, 1963 and June 11, 1963, Mr. Roberto A. Gianzon, general counsel of petitioner, requested a reinvestigation of the assessment which was granted. After the re-investigation, petitioner requested more time to verify its purchases of molasses from, and payments made to, the Associated Sugar, Inc. and to Mr. Alfredo Garcia.

3. The records of the case show that several attempts were made by respondent's examiner de Guia to verify the records of the Associated Sugar, Inc. and Mr. Alfredo Garcia relative to their transactions with petitioner involving molasses purchased, but said examiner was merely informed that there was no transaction involving sale of molasses during the crop year 1959-1960 between the parties concerned,

and Associated Sugar, Inc. simply refused to show its records without a clearance from its main office at Cubao, Quezon City.

4. On December 3, 1964, a demand for payment of the deficiency specific tax in the amount of ₱153,103.70, inclusive of compromise penalty, was reiterated and sent to petitioner. A warrant of distraint and levy was even issued against petitioner on January 6, 1965 but was later lifted on March 24, 1965.

5. In order that its administrative appeal can be given due course, petitioner was made by respondent on December 13, 1965 to execute a waiver form extending the prescriptive periods of assessment and collection.

6. The case was eventually referred to the Appellate Division of the Bureau of Internal Revenue where it was heard. On August 16, 1968, respondent finally denied petitioner's request for reconsideration and reiterated his demand for payment of the deficiency specific tax of ₱152,803.70, plus the sum of ₱300.00 as compromise penalty. Hence this appeal.

A lot of ground can at once be covered, and it will greatly help simplify matters, if the numerous allegations, averments and arguments of the parties are reduced to basic factual and legal propositions that are beyond dispute, to wit:

1. The four (4) vouchers of the checks (Exhibits "G", "G-1", "G-2" and "G-3") found on pages 185-188 of the Bureau of Internal Revenue docket, issued by petitioner in favor of Associated Sugar, Inc. and Alfredo T. Garcia in the aggregate amount of ₱19,250.00 authorized "Advances for molasses purchases from Associated Sugar, Inc. for crop year 1959-1960" (see also pp. 140-141 ts.n.) and not in payment of molasses purchases.

2. The Check Register (Disbursement Book) of petitioner shows that on November 4, 6 and 11, 1959, it purchased molasses from Associated Sugar, Inc. which were paid with (BPI) Bank of the Philippine Islands Checks No. A-86607 - ₱12,000; No. A-86614 - ₱5,000; and No. A-86616 - ₱1,000, respectively, or in the aggregate amount of ₱18,000.00; and on December 15, 1959, petitioner likewise purchased molasses from Alfredo T. Garcia which was paid with BPI Check No. A-96009 in the amount of ₱1,250.00.

3. The Ledger Account (Molasses Inventory - Account No. 103) of petitioner discloses that an inventory of its molasses is taken at the end of each month. On November 30, 1959, "molasses purchased" valued at ₱18,000.00 was included in the inventory of molasses which tallies with petitioner's alleged

Sugar, Inc. On December 31, 1959, "molasses purchased" valued at ₱1,250.00 was likewise included in the molasses inventory of petitioner which again tallies with the purchase of molasses on December 15, 1959 from Alfredo T. Garcia.

4. The financial statements of petitioner for the fiscal year 1959-1960 (Balance Sheet dated October 31, 1960, p. 76, CTA records), as certified by its external auditors - Messrs. Artemio M. Tulio & Associates - at the close of the tax year involved, show that the amounts reflected in the four (4) vouchers mentioned under No. 1 were taken up as advances against molasses, instead of being taken up as molasses inventory. The auditors' report pertained to records existing as of October 31, 1960 and the report was dated November 24, 1960. (Exhibits "N", "N-1" and "N-2", pp. 75-76, CTA records.)

5. The aggregate amount of ₱19,250.00 involved in the four (4) vouchers as aforementioned was taken up as part of accounts receivables in the income tax return of petitioner for the same fiscal year 1959-1960. (Exhibit "H-6", p. 191, BIR records; pp. 48-50, t.s.n.)

Petitioner and respondent do not dispute the foregoing facts. The dispute arises from the conclusions drawn by each of them. Respondent concludes that the four (4) checks issued by petitioner in favor of Associated Sugar, Inc. and Alfredo T. Garcia in the aggregate amount of ₱19,250.00 as evidenced by the four (4) vouchers were not advances but were in payment of molasses purchased and actually received by petitioner as shown by the entries in petitioner's check register and molasses inventory ledger. Contrariwise, petitioner contends that the payments made to Associated Sugar, Inc. and Alfredo T. Garcia as shown in the above-mentioned vouchers were actually advances to that company and Alfredo T. Garcia, which were erroneously entered in the check register and molasses inventory ledger as molasses purchases. The basic and decisive issue in this case is whether or not the molasses for which the advances or payments were made were actually delivered and distilled into alcohol, the specific tax on which had not been paid by petitioner.

Based solely on the particulars in the vouchers, there is no question that the payments made in favor of Associated Sugar, Inc. and Alfredo T. Garcia in the aggregate amount of ₱19,250.00 were for <u>advances for molasses purchases</u>, which in everyday parlance means "money furnished before its equivalent is received." However, these vouchers were entered as purchases instead of advances in the molasses inventory ledger and the check register of petitioner. From these bookkeeping entries respondent now disputes the correctness of the vouchers and relying solely on the said bookkeeping entries, concluded that the molasses for which the advances were extended were actually received and distilled into alcohol by petitioner.

Paragraph 2 of Section 150 of the National

Internal Revenue Code reads:

> SEC. 150. Records to be kept by manufacturers—Assessment based thereon. x x x
>
> The records of raw materials kept by such manufacturers may be used as a species of evidence by which to determine the amount of specific taxes due from them, and whenever the amount of raw materials received into any factory exceeds the amount of manufactured or partially manufactured products on hand and lawfully removed from the factory, plus waste removed or destroyed, and a reasonable allowance for unavoidable loss in manufacture, the Commissioner of Internal Revenue may assess and collect the tax due on the products which should have been produced from the excess.

What evidence may be used to determine the amount of specific tax due from manufacturers of articles subject to specific tax? The law specifies: "the records of raw materials kept by such manufacturers." When may such records of raw materials be used as evidence for the purpose of determining the amount of specific tax? The same law gives the ready answer. It says "whenever the amount of raw materials received into any factory exceeds the amount manufactured or partially manufactured products on hand and lawfully removed from the factory, plus waste removed or destroyed, and a reasonable allowance for unavoidable loss in manufacture." And what should be the basis of the assessment and collection of the tax by the Commissioner of Internal Revenue? Again the same law states: "on the products which should have been produced from the excess " of raw materials received." The accent is on the words "raw materials received." Accordingly, a manufacturer of articles subject to specific tax cannot be held liable, under Section 150 of the Revenue Code, for specific tax on products which should have been produced from the excess of raw materials not actually received by him.

Now back to the case at bar. What evidence was used by respondent to determine the amount of ₱152,803.70 as deficiency specific tax due from petitioner? From the check register and molasses inventory ledger, but certainly not the raw materials account or record of petitioner. Do these check register and molasses inventory ledger show that the molasses for which the advances made to the Associated Sugar, Inc. or to Alfredo Garcia were received by petitioner? "Except the checks which were the evidence of the transaction," respondent's examiner de Guia categorically stated during the hearing of this case before this Court that no record of petitioner was seen by him whether or not these molasses were actually delivered (p. 147, t.s.n.). As a matter of fact, the said examiner, in his report dated January 4, 1963 (Exhibit "1" for respondent, on the pertinent portion appearing on page 27 of the

BIR record), stated that "the raw materials account shows that all those molasses recorded came only from the Talisay-Silay Milling Company. The said raw materials account does not even show any molasses purchased from the Associated Sugar, Inc. or from Alfredo Garcia above-mentioned." While the distillery superintendent of petitioner, Mr. Leon G. Moya, stated that the distilling company received only for the fiscal period 1959-1960 molasses from Bacolod-Murcia Milling, Inc. and none from other sources, it was explained during the hearing of this case before this Court that "instead of Bacolod-Murcia delivering physically its molasses from their tanks to the Distillery they just got molasses from Talisay-Silay and in turn Bacolod-Murcia substituted the quantity advanced by Talisay-Silay Milling Company to the Distillery" (pp. 51-53, t.s.n.).

Even on the assumption, therefore, that the molasses inventory ledger and the check register, which are only subsidiary books of accounts, may be considered as forming part of the records of raw materials kept by petitioner, still the book entries can hardly be used as basis of the assessment of the deficiency specific tax under consideration because there is no evidence whatsoever of the delivery (and/or receipt by) petitioner of the molasses for which advances were made to the Associated Sugar, Inc. or to Alfredo Garcia. And on the strength of the finding of respondent's examiner himself that the raw materials account does not even show any molasses purchased from the Associated Sugar, Inc. or from Alfredo Garcia, it is evident that no molasses could have been illegally distilled into alcohol by petitioner on which the specific tax in question may be imposed.

At any rate, it will be noted that the financial statement of petitioner for the fiscal year ended October 31, 1960, the taxable year involved, as certified to by the external auditors, reflect these payments as "advances against molasses." While respondent seeks to discredit the correctness of this financial statement by arguing that it has its sources from entries in the books of accounts, it is a recognized accounting and auditing requirement that external auditors, in the preparation of financial statements, should verify and examine the book entries, specially accounts receivables, and not merely rely on what are reflected in the books of accounts or other subsidiary records. Otherwise, the purpose of Section 334 of the National Internal Revenue Code that books of accounts and records are subject to examination and audit yearly by independent certified public accountants in cases where the gross quarterly receipts or earnings of taxpayers exceed ₱25,000.00, and petitioner is one of them, and their income tax returns accompanied with certified balance sheets, profit and loss statements, schedules listing income-producing properties and the corresponding incomes therefrom and other relevant statements, would be defeated and nullified. Only by such confirmation, verification and substantiation as to the exact nature, veracity, scope and extent of the book entries can independent certified public accountants determine and certify whether or not the books of accounts and other records of taxpayers clearly reflect their transactions. In case of conflict, therefore, between book entries and certified financial statements, the latter would be more reliable.

Worthwhile noting also is the observance and compliance of petitioner, at least during the fiscal year under review, with all the requirements and procedures prescribed by the Revenue Code and the internal revenue regulations in connection with the operation of its business as distiller, rectifier and denaturer of alcohol. As shown by Exhibits "A" and "B", the internal revenue authorities were duly informed of the dates of the start of fermentation, subsequent distillation and cessation of distillation.

Exhibit "C" shows that petitioner submitted a final report dated October 31, 1960 of its production for the year involved. The monthly accounting of raw materials received and used, and distilled spirits produced, jointly accomplished by the officers of petitioner and respondent's representatives in the distillery (Exhibits "D" to "D-11") were properly filed and submitted to the Bureau of Internal Revenue. When fermentation and distillation were in process, the statement of molasses received and used, and rectified alcohol produced (Exhibit "F"), was prepared and submitted. The monthly statements of rectified spirits manufactured and removed (Exhibits "E" to "E-23") were all properly accomplished and submitted to the Bureau of Internal Revenue. These reports were duly attested to by the Bureau of Internal Revenue Officer assigned to the distillery. There being no indication whatsoever of any unreported distillation of petitioner or connivance of the latter with any revenue officer assigned to the distillery, and mindful of the official intervention and supervision by respondent's representatives in the operation of said distillery as required by law, all these factors, taken together, militate against the possibility of petitioner having illegally received and distilled the alleged unrecorded molasses in question for which the advances under consideration were made.

In the light of the above, it can not be said that the molasses for which the advances in the total amount of ₱19,250.00 were actually received and distilled into alcohol by petitioner. Consequently, petitioner Talisay-Bacolod Distilling Co., Inc. can not be held liable for the deficiency specific tax amounting to ₱152,803.70 for the year 1959-1960.

WHEREFORE, the appealed decision is reversed. No pronouncement as to costs.

SO ORDERED.

Quezon City, October 17, 1974.

ROMAN M. UMALI
Presiding Judge

WE CONCUR:

ESTANISLAO R. ALVAREZ
Associate Judge

RAMON L. AVANCEÑA
Associate Judge