Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

EN BANC

PHILIPPINE TOBACCO FLUE-CURING AND REDRYING CORPORATION,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA EB CASE NO. 566
(CTA Case No. 7377)

Present:
ACOSTA*, P.J.,
CASTAÑEDA, JR.
BAUTISTA
UY
CASANOVA
PALANCA-ENRIQUEZ
FABON-VICTORINO
MINDARO-GRULLA
COTANGCO-MANALASTAS, JJ.

Promulgated: OCT 2 2 2010

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DECISION

MINDARO-GRULLA, J.:

Submitted for decision is a Petition for Review for the Court *en banc* under Rule 8, Section 4 (b), of the 2005 Revised Rules of the Court of Tax Appeals, as amended, of the Decision[1] dated August 10, 2009, rendered by this Court's former Second Division[2] in CTA Case No. 7377, and its Resolution[3] dated October 30, 2009.

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[1] En banc Docket, pp. 27-51.
[2] Penned by Associate Justice Olga Palanca-Enriquez, concurred in by Associate Justice Juanito C. Castañeda, Jr. and Associate Justice Erlinda P. Uy.
[3] En banc Docket, pp. 53-54.

Petitioner seeks a reversal of both the aforesaid Decision and Resolution, the dispositive portions of which, respectively, read as follows:

Decision dated August 10, 2009:

> "*WHEREFORE, premises considered, the present Petition for Review is hereby **DISMISSED** for lack of merit. Accordingly, petitioner is hereby **ORDERED TO PAY** the respondent the amount of **ONE MILLION SEVEN HUNDRED TWENTY THOUSAND TWENTY TWO and 47/100 PESOS (P1,720,022.47)**, representing its deficiency excise tax for the period covering January 1, 2002 to March 31, 2004.*
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> *In addition, petitioner is hereby **ORDERED TO PAY** a delinquency interest equivalent to twenty (20%) per annum on the amount of P1,720.022.47 from March 1, 2005, until full payment thereof, pursuant to Section 249(C)(3) of the NIRC of 1997, as amended.*
>
> ***SO ORDERED.**"*

Resolution dated October 30, 2009:

> "*WHEREFORE, premises considered, petitioner's "Motion for Reconsideration" is hereby **DENIED** for lack of merit.*
>
> ***SO ORDERED.**"*

The undisputed facts are stated hereunder.

Petitioner Philippine Tobacco Flue-Curing and Redrying Corporation (or PTFC) is a corporation primarily engaged in the business as a tobacco dealer and is classified as an L-6 permittee[4].

[4] Joint Stipulation of Facts and Issues, this Court's former Second Division Docket, pp. 133-136.

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Respondent is the duly appointed Commissioner of Internal Revenue ("CIR"), vested with authority to exercise the functions of said office, including *inter alia*, the power to abate or cancel a tax assessment.[5]

On February 7, 2005, petitioner received a Formal Letter of Demand dated January 19, 2005, with Details of Deficiency Excise Tax on Removals of Partially Manufactured Leaf Tobacco, and an Audit Result/Assessment Notice dated January 18, 2005, for deficiency excise tax amounting to ₱1,720,022.47[6], computed as follows[7]:

Volume of Removals of Partially Manufactured Tobacco(in kgs.)	1,364,297
Multiplied by Tax Rate	0.75
Basic Deficiency Excise Tax	₱1,023,222.75
Add: 25% Surcharge	255,805.69
Interest up to 2-28-05	440,994.03
Total Deficiency Excise Tax Due	₱1,720,022.47
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On February 28, 2005, petitioner filed an administrative protest against the abovementioned deficiency tax assessment. Thereafter, on April 28, 2005, petitioner filed a Supplemental Protest letter.

On November 23, 2005, petitioner filed a petition for review before this Court due to respondent's inaction. The same was raffled to this Court's former Second Division.

The parties stipulated on the following issues for consideration:

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[5] Ibid.
[6] Ibid.
[7] Exhibit "H", this Court's former Second Division Docket, pp.122-123

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"1. *Whether or not petitioner is liable for deficiency excise tax on stemmed leaf tobacco based on Sec.144 of the NIRC of 1997.*

2. *Whether or not the ruling in the case of Commissioner of Internal Revenue vs. La Campana Fabrica de Tabacos, Inc. is applicable to this case.*

3. *Whether or not Sec. 130 (A)(2) of the NIRC of 1997 is applicable to the petitioner.*

4. *Whether or not petitioner is liable to pay the amount of ₱ 1,720,022.47 for the period beginning January 1, 2002 up to March 31, 2004 as deficiency excise tax.*

5. *Whether or not the Honorable Court of Tax Appeals has jurisdiction in this Case."*

After trial, this Court's former Second Division rendered the assailed Decision[8] citing Commissioner of Internal Revenue vs. La Campana Fabrica de Tabacos, Inc.[9]*(**La Campana Case**)*, Compania General de Tabacos de Filipinas vs. Court of Appeals[10] ***(Compania Case)***and Commissioner of Internal Revenue vs. La Suerte Cigar and Cigarette Factory, Inc.[11]*(**La Suerte Case**)*.

The pertinent portion of the assailed Decision reads:

> *"Considering further that there is no showing that petitioner has been recognized as an L-7 tobacco manufacturer, thus, it cannot be exempt from the payment of excise tax under Section 140.*
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> *Thus, petitioner cannot be exempt from the payment of excise tax under Section 144.*

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[8] This Court's former Second Division Docket, pp. 446-470
[9] G.R. No. 145275, November 15, 2001, 369 SCRA 122
[10] G.R. No. 147361, March 23, 2004, 426 SCRA 210
[11] G.R. No. 139803, September 2, 2005, 469 SCRA 346.

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> *In sum, the Court finds petitioner liable for deficiency excise tax covering the period from January 1, 2002 to March 31,2004."*

Petitioner filed therefrom a Motion for Reconsideration[12] which was denied in a Resolution[13] dated October 30, 2009. Hence, petitioner filed this Petition for Review before the Court en banc.

At the outset, on September 9, 2010, petitioner filed a "Manifestation with Motion" alleging that it had applied for an abatement or cancellation of the delinquency interest and also paid the deficiency excise tax thereon. Thus, petitioner prayed for the reduction of its surety bond. However, the records show that no evidence was presented to prove that petitioner's application for an abatement or cancellation of the delinquency interest was approved and granted by respondent. Thus, petitioner's motion for reduction of the surety bond is deemed moot and academic.

In assailing the Decision and Resolution of this Court's Division, petitioner raised this sole issue:

> "WITH DUE RESPECT TO THIS HONORABLE COURT'S (FORMER)2ND DIVISION, IT GRAVELY ERRED IN NOT FINDING THAT PETITIONER IS NOT LIABLE FOR DEFICIENCY EXCISE TAX ON STEMMED LEAF TOBACCO BASED ON SEC. 144 OF THE NIRC OF 1997."

Simply stated, the issue raised is whether petitioner is subject to excise tax on stemmed leaf tobacco.

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[12] This Court's former Second Division Docket, pp. 473-493
[13] This Court's former Second Division Docket, pp. 501-502

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Petitioner's arguments that it is not liable for the deficiency excise tax on stemmed leaf tobacco are summarized as follows:

> 1. Revenue Regulations No. 17-67 which includes and classifies "stemmed leaf tobacco" as "partially manufactured tobacco" is unconstitutional, resulting to administrative legislation. The "partially manufactured tobacco" that Section 144 of the NIRC of 1997 subjected to excise tax is not the same as the stemmed leaf tobacco which Section 140 of the same Code exempted from payment. The prolonged practice in not subjecting stemmed leaf tobacco to excise tax proves that no excise taxes were intended to be imposed thereon and that the exemption from payment of excise tax under Sec. 140 is broad enough to cover all kinds of tobacco manufacturers, without distinction.
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> 2. The La Campana case is inapplicable. In the said case, the L-6 permittee (transferor) was not held liable for deficiency excise tax but rather the L-7 permitee (transferee) was held liable. Thus, in the present case it should be the transferee[14] (Philip Morris Phil Inc. and Mighty Corporation) that should be held liable for the excise tax.
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> 3. Pursuant to Sec. 130 (A) (2) of the NIRC of 1997, it is the manufacturer that should be held liable for the payment of excise tax. Petitioner, being in the class of "wholesale leaf tobacco dealers" is not a manufacturer or producer, thus, not liable for the payment of excise tax.

We find no merit in petitioner's arguments.

Petitioner is subject to excise tax on stemmed leaf tobacco.

Petitioner was assessed pursuant to Revenue Memorandum Circular (RMC) No. 18-2002[15] and Section 144[16] of the NIRC of 1997.

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[14] En Banc Docket, p. 21

[15] Interpretation of the pertinent provision of Section 140 of the National Internal Revenue Code of 1997 by the Supreme Court of the Philippines in G.R. No. 145275.

[16] SEC.144. Tobacco Products.- There shall be collected a tax of (P0.75 on each kilogram of the following products of tobacco:

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Said Revenue Memorandum Circular cited the La Campana Case[17] the pertinent portion of which reads:

> *"We agree with the petitioner that the exemption from specific tax of the sale of stemmed leaf tobacco as raw material by one L-7 directly to another L-7 is because such stemmed leaf tobacco has been subjected to specific tax when an L-7 manufacturer purchased the same from wholesale leaf tobacco dealers designated under Section 3, Chapter I, Revenue Regulations No. 17-67(supra) as L-3, L-3F, L-3R, L-4, or L-6, the latter being also a stripper of leaf tobacco. These are the sources of stemmed leaf tobacco to be used as raw materials by an L-7 manufacturer which does not produce stemmed leaf tobacco. When an L-7 manufacturer sells the stemmed leaf tobacco purchased from the foregoing suppliers to another L-7 manufacturer as raw material, such sale is not subject to specific tax under section 137(now Section 140), as implemented by Section 20(a) of Revenue Regulations No. V-39. xxx'*
>
> *In view of the said Supreme Court decision,* ***all removals of stemmed leaf tobacco by leaf tobacco dealers (i.e. L-3, L-3 ¼, L-3R, L-4, L-6) are subject to the specific tax of ₱ 0.75 per kilogram imposed under Section 144 of the NIRC****, in addition to the inspection fee imposed under Section 146 of the same Code. However,* ***removals of said leaf tobacco product by an L-7 (a manufacturer of tobacco products) shall be exempt from such specific tax pursuant to the said Supreme Court decision.*** *xxx" (Emphasis supplied)*

(a) Tobacco twisted by hand or reduced into a condition to be consumed in any manner other than the ordinary mode of drying and curing;

(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, stems and sweepings of tobacco.

Fine 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 excise tax herein provided for under such conditions as may be prescribed in the rules and 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 manner, on each kilogram, Sixty centavo (P0.60).

[17] Supra. Note 9

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The abovementioned Revenue Memorandum Circular is in accord with Revenue Regulations No. 17-67 which classifies stemmed-leaf tobacco as "partially manufactured tobacco". The classification of stemmed leaf tobacco as "partially manufactured tobacco" was the rationale why petitioner was assessed pursuant to Sec 144 of the NIRC of 1997.

The validity of Revenue Regulations No. 17-67 has been upheld by the Supreme Court in Compania General de Tabacos de Filipinas vs. Court of Appeals[18] and Commissioner of Internal Revenue vs. La Suerte Cigar and Cigarette Factory, Inc.[19]

We quote this Court's former Second Division:

> *"Petitioner's contention that the classification of 'stemmed leaf tobacco' as "partially manufactured tobacco" is improper since Revenue Regulations No. 17-67 is an administrative legislation in a prohibited sense is untenable. This issue is not novel, as said issue had already been settled by the Supreme Court in the case of Compania General de Tabacos de Filipinas vs. Court of Appeals, G.R. No. 147361, March 23,2004, 426 SCRA 210, and reiterated in the subsequent case of Commissioner of Internal Revenue vs. La Suerte Cigar and Cigarette Factory, Inc., G.R, No. 139803, September 2, 2005, 469 SCRA 346. In the case of Compania General de Tabacos de Filipinas vs. Court of Appeals, the Supreme Court ruled:*
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>> *'Petitioner's arguments impugning the validity of Revenue Regulations Nos. V-39 and 17-67 deserve scant consideration. First, both regulations were issued pursuant to Section 245 (now 244) of the Tax Code. The authority of the Secretary of Finance, in conjunction with the*

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[18] Supra. Note 10
[19] Supra. Note 11

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> *Commissioner of Internal Revenue, to promulgate needful rules and regulations for the effective enforcement of the internal revenue laws cannot be controverted. Such rules and regulations, as well as administrative opinions and rulings, ordinarily deserve to be given weight and respect by the courts. Second, our scrutiny of Revenue Regulations Nos. V-39 and 17-67 clearly shows that said regulations did not modify or deviate from the text of Section 137 (now140) and 141 (now 144) but merely implemented and clarified said two provisions by providing certain conditions under which stemmed leaf tobacco may be exempted from prepayment of taxes.'*

Clearly, to be exempted from the payment of tax under Sec 140 and 144 of the Tax Code, the taxpayer must comply with the rules and regulations, as well as the administrative opinions and rulings set forth by the Secretary of Finance, in conjunction with the Commissioner of Internal Revenue, among others, Revenue Regulations No. 17-67, which the Supreme Court held to be valid.

In relation to Section 144 of the Tax Code, there is no basis as to petitioner's claim of exemption under Section 140 of the Tax Code on grounds of the claim of inapplicability of the La Campana Case and the contention that petitioner, being merely a tobacco dealer and not a manufacturer exempts it from liability.

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Admittedly, petitioner is an L-6 permittee[20]- defined in Revenue Regulations No. 17-97, as follows:

> "(g) L-6 – Wholesale leaf tobacco dealers who, exclusively for export, except as otherwise provided for in these regulations perform the following functions:
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> (1) Handstripped and/or thresh whole leaf tobacco for themselves or for other L-6 or L-7 permittees;
>
> (2) Re-process partially manufactured tobacco for themselves, or for other L-6 or L-7 permittees;
>
> (3) Sell their partially manufactured tobacco to other L-6 permittees;"

Based on the aforesaid definition, petitioner as an L-6 permittee, is considered a "manufacturer", as it handstripped and/or thresh whole leaf tobacco, re-process partially manufactured tobacco and sell their partially manufactured tobacco to other L-6 or L-7 permittees. Pursuant to Section 130(A)(2), in relation to Section 144 of the NIRC of 1997, an L-6 permittee can be held liable for excise tax.

We quote with approval this Court's former Second Division:

> *"Considering that under Section 130(A)(2), the manufacturer or producer of domestic product is liable to pay the excise tax before the removal from the place of production and the uncontroverted fact that petitioner is engaged in the "manufacture or partial manufacture of tobacco" since it purchased cured leaf tobacco, removed the stems through the*

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[20] Supra. Note 4

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process of threshing, re-dried the threshed leaf, and then packed the re-dried products into cardboard cases or Hessian bales, clearly shows that it is liable xxx"

Further, petitioner, being an L-6 permittee, is not entitled to the exemption of payment of tax under of Section 140 of the NIRC of 1997 which requires compliance with the conditions as may be prescribed by the Secretary of Finance.

We quote:

"Section 140. 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 rules and regulations prescribed by the Secretary of Finance. Stemmed leaf tobacco, fine-cut short, the refuse of fine-cut chewing tobacco, scraps, cuttings, clippings, stems or mid-ribs, 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 prescribed in the rules and regulations prescribed by the Secretary of Finance. xxx."

The interpretation of the abovementioned provision was expounded in the La Campana Case which was the basis of clarification in the Revenue Memorandum Circular (RMC) No. 18-2002[21].

The Supreme Court held that:

" 'Stemmed leaf tobacco,' as herein used means leaf tobacco which has had the stem or mid-rib removed. The term does not include broken leaf tobacco.'

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[21] Interpretation of the pertinent provisions of Section 140 of the National Internal Revenue Code of 1997 by the Supreme Court of the Philippines in G.R. No. 145275.

Thus, the conditions under which stemmed leaf tobacco may be transferred from one factory to another without prepayment of specific tax are as follows:

(a) The transfer shall be under an official L-7 invoice on which shall be entered the exact weight of the tobacco at the time of its removal.

(b) Entry shall be made in the L-7 register in the place provided on the page removals.

(c) Corresponding debit entry shall be made in the L-7 register book of the factory receiving the tobacco under the heading "Refuse, etc., received from the other factory," showing the date of receipt, assessment and invoice numbers, name and address of the consignor, form in which received, and the weight of the tobacco.

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Thus, under Sec. 3(h) of Revenue Regulations No. 17-67, L-7 refers to "Manufacturers of tobacco products." Hence, the transferor of the stemmed leaf tobacco must be an L-7 tobacco manufacturer. This is so because obviously only an L-7 tobacco manufacturer has an official L-7 invoice and an L-7 register and the transferee of the stemmed leaf tobacco must also be an L-7 tobacco manufacturer because, to repeat, only an L-7 tobacco manufacturer has an L-7 registry book.

xxx xxx xxx

We agree with the petitioner that the exemption from specific tax of the sale of stemmed leaf tobacco as raw material by one L-7 directly to another L-7 is because such stemmed leaf tobacco has been subjected to specific tax when an L-7 manufacturer purchased the same from wholesale leaf tobacco dealers designated under Section 3, Chapter I, Revenue Regulations No. 17-67 (supra) as L-3, L-3F, L-3R, L-4, or L-6, the latter being also a stripper of leaf tobacco. These are the sources of stemmed leaf tobacco to be used as raw materials by an L-7 manufacturer which does not produce stemmed leaf tobacco. When an L-7 manufacturer sells the stemmed leaf tobacco purchased from the foregoing suppliers to another L-7 manufacturer as raw material, such sale is not subject to specific tax under Section 137 (now Section 140), as implemented by Section 20(a) of Revenue Regulations No. V-39.

Consequently, respondent's purchases of stemmed leaf tobacco were not exempt from specific tax."

Accordingly, a taxpayer is not subject to tax under Section 140 of the NIRC of 1997 when an L-7 manufacturer sells (transferor) the stemmed leaf tobacco to another L-7 manufacturer (transferee), because only an L-7 permittee has an official L-7 invoice and an L-7 register.

Petitioner is an L-6 permitee, not an L-7 permittee. There is nothing in the said Supreme Court ruling which suggests, even by implication, that an L-6 permittee(transferor) is exempt from the payment of excise tax. Tax exemptions are never presumed.[22] It is a settled rule that tax exemptions are construed *strictissimi juris* against the taxpayer and liberally in favor of the taxing power. He who would seek to be thus privileged must justify it by words *too* plain to be mistaken and *too* categorical to be misinterpreted.[23] Taxes are the lifeblood of the nation, therefore statutes that allow exemptions are construed strictly against the grantee and liberally in favor of the government.[24] Evidently, petitioner is not exempt from the payment of excise tax on stemmed leaf tobacco.

In fine, we find no cogent reason to reverse the findings of this Court's former Second Division.

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[22] Smart Communications, Inc. vs. City of Davao, G.R. No. 155491, September 16, 2008
[23] Sea-Land Service Inc. vs. Court of Appeals, et al. G.R. No. 122605, April 30,2001
[24] Davao Gulf Lumber Corp. vs. Commissioner of Internal Revenue, G.R. No. 117359, July 23, 1998, 293 SCRA 76, 77.

WHEREFORE, the instant Petition for Review is hereby **DENIED**. The Decision of this Court's former Second Division in CTA Case No. 7377, dated August 10, 2009, and its Resolution dated October 30, 2009, are **AFFIRMED**. No pronouncement as to costs.

SO ORDERED.

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

(On Leave)
LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation among the members of the Court En Banc before the case was assigned to the writer of the opinion of the Court En Banc.

ERNESTO D. ACOSTA
Presiding Justice