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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

3M PHILIPPINES, INC.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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3887 -

C.T.A. CASE NO. 3883

3/23/88

D E C I S I O N

This is a petition to review the decision of respondent dated September 28, 1984 denying petitioner's request to cancel and withdraw the deficiency sales tax assessment issued amounting to P342,357.97.

Petitioner, 3M Philippines, Inc., is a domestic corporation wholly owned by Minnesota Mining and Manufacturing Co., a non-resident foreign corporation located at St. Paul, Minnesota, U.S.A., with offices at 3M House, Guadalupe, Makati, Metro Manila. It is engaged in the manufacture of adhesive tapes and other articles such as abrasives, scouring materials and reflectors using the brand of its parent company, from which the raw materials used in the production were imported. These imported materials are gigantic in sizes contained in big rolls, hereinafter described as "jumbo" materials (Exhibit "F", "G", and "H", pp. 40-41, CTA records). The imported "jumbo" materials are cut into small sizes and packed for resale to consumers (Exhibit "F-1", "G-1", and "H-1", pp. 40-41, CTA records).

On August 30, 1976, respondent assessed petitioner the sum of P342,357.97, representing deficiency sales tax for the period from September 1, 1973 to October 31, 1974, including surcharge and interest, computed as follows: (p. 149, BIR records)

Amount subject to deficiency sales tax per investigation	P3,193,723.40
7% sales tax due thereon	P 223,560.64
25% surcharge for late payment	55,890.16
	P 279,450.80
14% interest per annum from January 21, 1975 to September 30, 1976	62,907.17
TOTAL AMOUNT DUE	P 342,357.97

Petitioner received the assessment letter on October 11, 1976 and protested the same in its letter dated October 28, 1976 which respondent received on November 3, 1976.

On December 17, 1984, petitioner received the decision of respondent dated September 28, 1984 denying its request to cancel and withdraw the deficiency sales tax assessment notice issued to petitioner.

Hence, the present petition for review.

The issue herein raised is whether or not there was an overstatement in the cost of "jumbo" raw materials in the amount of P2,652,875.59 that would result to double deduction if considered deductible from the gross selling price.

Respondent in his special and affirmative defenses contend that the cost of these imported "jumbo" materials were already deducted for sales tax purposes in accordance with section 186 in relation to Section 194(x) both of the 1974 Tax Code.

The BIR examiners disclosed as per its investigation that the raw materials deducted from the gross selling price was overstated by P2,652,875.59. Consequently, the sales tax separately billed to its customers, amounting to

P540.847.81, was erroneously computed, therefore, the same should not have been deducted from the gross selling price by virtue of BIR General Circular No. 431. Thus, the total amount of P3,193,723.40 should not have been deducted from the gross selling price. For a more picturesque view, the BIR presented its proposed assessment for the fiscal year ended October 31, 1974, as follows: (p. 41, BIR records)

Computation of deficiency sales tax:

Raw Materials (R/M) and Packaging Supplies (P/S) deducted per sales tax return	P6,814,524.58
Allowable deductible R/M & P/S per investigation ...	4,161,648.99
Overstated deductible R/M & P/S	P2,652,875.59
Add: Sales tax paid (Separately billed in sales invoice) Per BIR Gen. Cir. No. 431, the tax billed must be correctly computed, in order to be deductible from the gross selling price	P 540,847.81
Total amount subject to deficiency sales tax	P3,193,723.40
	x 7%
	P 223,560.64

Deficiency sales tax 25% surcharge for late payment	55,890.16
Deficiency sales tax plus surcharge	P 279,450.80

Petitioner, on the other hand, maintains that, as a manufacturer, it is entitled to deduct the cost of raw materials, likewise subject to tax, from the gross selling price or gross value in money of the manufactured goods pursuant to Section 186 and 189 in relation to Section 194(x) of the 1974 Tax Code.

Section 194(x) defines a manufacturer as to include every person who by physical or chemical process alters the quality of any raw material or manufactured or partially manufactured product so as to reduce it to marketable shape or prepare it for any of the uses of industry.

In its arduousness to refute the assessment, petitioner claims that pursuant to a directive of its parent company, the "jumbo" materials received therefrom, after payment of the corresponding customs duties and taxes and upon release from customs custody, are recorded in its books of accounts as purchases of finished goods inventory -

specified as "jumbo" materials. They do not form part of t e materials of other locally manufactured finished goods but instead form part of locally converted goods, by virtue of the fact that they are cut into small sizes and by the use of other manufacturing process which changes their forms, whose domestic sales are also subjected to the 7% manufacturer's sales tax (Exhibit "E", p. 39, CTA records, underscoring ours).

It is noteworthy to point out that in computing the sales tax on locally converted goods, petitioner deducts the cost of the "jumbos", other tax paid raw materials, and packaging materials (p. 50, CTA records).

After a careful review of the record, We have found no reason at all to disturb the findings of the BIR examiners. The issue is not one of deductibility but rather one of overstatement in the cost of raw materials deducted in the gross sales of its manufacturing operations. We therefore find petitioner's allegations unmeritorious.

In fact, the cost accountant of petitioner revealed during trial that the sales tax liability for the year ended October 31, 1974 was computed on the basis of the gross sales less the sales returns, arriving at the net sales minus the cost of deductible materials which represents the cost of locally manufactured items and the cost of locally converted items (underscoring supplied). The balance is taxable net sales out of which the 7% sales tax is based (p. 17, t.s.n., July 16, 1985). We stress that the cost of locally converted goods have already been considered as a deduction in computing the sales tax liability of petitioner. Therefore, to uphold petitioner's claim that the same should be deducted from the gross selling price of its manufacturing operations would entail double deduction. It would be absurd if such would be allowed.

Petitioner, in support of his claim, submitted the following revised Statement of Cost of Goods Sold for Trading only and a Statement of Cost of Goods Manufactured for the year ended October 31, 1974, as compared with the original statements submitted, to wit:

Statement of Cost of Goods Sold
(Trading Only)

	Original (Exhibit "B", p. 34, CTA rec.)	Revised (p. 26, BIR records)
Finished goods - Purchases (Beg.)	P 8,863,335.00	
Add: Purchases	39,009,434.00	
Cost of Goods Available	P47,872,769.00	
Less: Finished goods- Purchases (End)	P22,106,057.00	
Other disposals	1,024,783.00	
	P23,130,840.00	
Cost of sales (Trading only)	P24,741,929.00	P24,741,929.00
Less: Cost of sales (locally converted items & sold the same year)		* 2,464,700.44
		P22,277,228.56
Add: Operating Expenses		
Inventory Control & Production Planning		P 167,996.90
Receiving, WHSG & SHPG		478,954.90
Equipment Service		512,717.27
		P 1,159,669.07
Cost of Sales - Trading Only		P23,436,897.63

Statement of Cost of Goods Manufactured
For the year ended October 31,1974

	Original (Exh. "A", pp. 31-33, CTA rec.)	Revised (Exh. "D", p. 36, CTA rec.)
Cost of Raw Materials (R/M) and Packaging Materials (P/M) Used	P5,244,862.00	P 5,244,862.00
Add: Locally converted items (imported finished goods		* 2,464,700.44
Total R/M & P/M Used	P5,244,862.00	P 7,709,562.44
Add: Conversion Cost		
Direct Labor	P1,541,310.00	P 765,132.40
Manufacturing Overhead	2,301,344.00	1,917,853.33
	P3,842,654.00	P 2,682,985.73
Total Manufacturing Cost	P9,087,516.00	P10,392,548.17

In the Revised Statement of Cost of Goods Sold (Trading Only), petitioner deducted the cost of sales of locally converted items amounting to P2,464,700.44, computed as follows: (p. 134, BIR records)

Manufacturing Statement - Jumbo
Fiscal Year Ended October 31, 1974

Inventory beg. - Nov. 1, 1973	P 390,685.90
Purchases	5,361,989.00
Jumbo Available for Use	P5,752,674.90
Less: Inventory end, October 31, 1974	3,287,974.46
Jumbo Used	P2,464,700.44

and transferred it to the Statement of Cost of Goods Manufactured by adding it to the cost of raw materials and packaging materials used on the ground that the same should be deducted as such considering that these "jumbo" materials have under gone a manufacturing process and were not actually sold as is.

However, the findings of the BIR examiners, to which We adhere, showed that the cost of imported finished goods ("jumbo" materials) were already included in the original statement of Cost of Goods Manufactured, this finds support upon examination of the purchases of imported raw materials and packaging materials in relation to the advance sales tax paid as shown below: (p. 78, BIR records)

Imported raw materials purchases, per orig. statement		P7,121,594.00
Imported packaging materials purchases, per orig. statement		60,804.00
Total		P7,182,398.00
Less: Cost of importation of raw and packaging materials per advanced sales tax paid -		
Landed Cost = A.S.T. / .0875		
= P418,305 / .0875		
	= P4,780,628.57	
Add: A.S.T.	418,305.00	5,198,933.57
Excess, representing imported finished goods		P1,983,464.43
Add: 25% mark-up		495,866.10
Total landed cost of imported finished goods		P2,479,330.53

The contention of petitioner that the difference representing imported finished goods were actually in-transit raw materials is not convincing since nothing is shown in the records to prove that such were actually in-transit raw materials. No evidence was adduced by petitioner to rebut the findings of respondent.

Based on the foregoing, We, therefore, see no valid reason to set aside the decision of respondent dated September 28, 1984.

WHEREFORE, the decision appealed from is hereby affirmed, and petitioner 3M Philippines, Inc. is ordered to pay respondent, Commissioner of Internal Revenue the sum of P342,357.97 representing deficiency sales tax for the period from September 1, 1973 to October 31, 1974, including surcharge and interest, at petitioner's costs.

SO ORDERED.

Quezon City, Metro Manila, March 23, 1988.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

ALEX Z. REYES
Associate Judge

C E R T I F I C A T I O N

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

Amante Filler

AMANTE FILLER
Presiding Judge
Court of Tax Appeals