REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
Quezon City

FORTUNE TOBACCO CORPORATION,
Petitioner,

-versus-

C. T. A. CASE NO. 4616

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
OCT 06 1994

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D E C I S I O N

This is a petition contesting a deficiency specific tax assessment on the importation of stemmed-leaf tobacco in the amount of P1,989,821.86 covering the period from July 1, 1989 to November 30, 1990.

Petitioner, Fortune Tobacco Corporation, is a domestic corporation engaged in the manufacture of cigarettes.

On March 20, 1991, petitioner received from the respondent Bureau a letter, dated March 1, 1991, demanding payment of the amount of P1,989,821.86 representing deficiency specific tax, inclusive of increments, on petitioner's importation of stemmed leaf tobacco covering the period from July 1, 1989 to November 30, 1990.

In answer to this letter of demand, petitioner, in a letter dated April 2, 1991, protested this "new assessment" contending that:

> "1. Imported stemmed leaf tobacco is not subject to the P0.75/kg tax levied under Section 141 of the Tax Code considering that (i) stemmed leaf tobacco is not included in the enumeration of products subject to tax under said Section 141, (ii) stemmed leaf tobacco, particularly when imported, cannot be deemed "partially prepared" tobacco under Section 141, (iii) Section 141 itself provides that certain products therein enumerated may be sold without payment of the tax therein provided if to be used in the manufacture of other tobacco products, and (iv) Section 137 of the Tax Code categorically exempts from the excise tax stemmed leaf tobacco when sold in bulk as raw material by one manufacturer directly to another.
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> "2. The instant purported assessment of P1,989,821.86 was issued against my client without observing procedural due process mandated in Section 229 of the Tax Code, as implemented by Revenue Regulations No. 12-85.
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> "3. The silent yet nonetheless implied revocation (with retroactive effect) of the previous BIR ruling and long standing practice regarding stemmed leaf tobacco (particularly) imported stemmed leaf tobacco) is violative of Section 246 of the Tax Code."

thus concluding and requesting that respondent cancel and withdraw said assessment.

On April, 18, 1991, respondent stood pat on his decision on the taxability of stemmed leaf tobacco in the inventory of petitioner and therefore considered the deficiency tax assessment final.

Administrative remedies having been closed to it, petitioner appealed the final decision of the assessment of respondent Bureau before this Court assigning three "errors" committed by respondent in its decision which are reiterations of the grounds raised in its administrative protest.

In his Answer to the Petition, respondent considered stemmed leaf tobacco, subject of the deficiency tax assessment, as "partially manufactured or prepared tobacco" as provided for in Revenue Regulations 17-67 [Sec. 1(1)]. If so, it is subject to a tax of P0.75 for each kilogram (Sec. 141, National Internal Revenue Code). It further averred that Section 137 of the Tax Code pertains to transfer of stemmed leaf tobacco as raw materials from one manufacturer of tobacco products (L-7) to another manufacturer of tobacco products (L-7). Revenue Regulations No. V-39, Sec. 20 thereof, refers explicitly to transfers from one L-7 directly to another L-7, but not from L-6 (stripper or thresher) to L-7. While imported leaf tobacco has never been subject to tax, partially manufactured tobacco is subject to the specific tax of P0.75/kg. Finally, that the assessment in question was issued in accordance with law and revenue regulations and all presumptions are in favor of the correctness of the assessment.

When this case was called for hearing on November 8, 1991, petitioner submitted as its evidence the Assessment Letter, dated March 1, 1991, assessing petitioner P1,989,821.86 for deficiency specific tax, inclusive of increments, on the importation of stemmed leaf tobacco covering the period from July 1, 1989 to November 30, 1990 (Exh. A). The letter of Atty. Abraham C. La Vina, in representation of the petitioner, addressed to the Commissioner of Internal Revenue, dated April 2, 1991, protesting the assessment (Exh. B) and the final decision of the Commissioner of Internal Revenue in his letter, dated April 18, 1991, affirming the deficiency specific tax assessment on the importation of stemmed leaf tobacco and demanding payment in the amount of P1,989,821.86 (Exh. C) were likewise submitted as part of its evidence. All these exhibits form part of the BIR records. No testimonial or other evidence was offered by the petitioner. In fact, after the aforesaid exhibits were formally offered, subject to the "admission by respondent", it rested its case (Hearing of November 8, 1991, p. 6 of tsn).

Respondent in turn submitted and formally offered as its evidence the following documents which form part of the BIR records:

> *Letter of Authority (ESP No. 024-90, November 15, 1990) issued to Revenue Officers Wilfrando Balangue, Paz Asuncion, Jose Salindong, Jr. and Dario Roxas, all with the Special Group of Excise Tax Service, to conduct stock-taking/investigation of Fortune Tobacco Corporation for "excise tax purposes" (Exh. 1).*
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> *Stocktaking Worksheet of Imported Leaf Tobacco, L-7 $^{1/2}$-11353 Account prepared by the Revenue Enforcement Officers for the period July 1, 1989 (beginning balance) to November 15, 1989 (Exh. 2).*
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> *Entry in Exh. 2, marked as Exh. 2-a - the number of cases (3,600) equivalent to 684,000 kilograms under the heading "imported burley" entered for December 1989.*
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> *Entry in Exh. 2, marked as Exh. 2-b : the number of 66 hogheads equivalent to 28,288 kgs. and the 3,888 cases equivalent to 77,580 kgs. under the heading "imported Virginia" entered for April 1990.*
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> *Entry in Exh. 2, marked as Exh. 2-c : the number of 5,613 cases equivalent to 1,122,600 kgs. under the heading "imported Virginia" entered for May 1990.*
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> *Entry in Exh. 2, marked as Exh. 2-d, the number of 216 cases equivalent to 43,200 kgs. under the heading "imported Virginia" entered for July 1990.*
>
> *Entry in Exh. 2, marked as Exh. 2-e, the number of 6,840 cases equivalent to 1,229,600 kgs. under the heading "imported burley" imported for January, 1990.*

Memorandum, dated February 13, 1991, submitted by Revenue Enforcement Officers Wilfrando V. Balangue, Dario B. Roxas and Jose Salindong, Jr., stating that pursuant to Section 141 (b) of the NIRC, the subject imported tobacco strips (L-7-1/2) totalling 1,747,518 kgs. are taxable at P0.75 per kilogram and recommending a total specific tax deficiency of P1,989,821.86, 20% interest included (Exh. 3).

Part of the report of the Revenue Examiners detailing the quantity of imported tobacco strips (1,747,518 kgs.) of which the amount of P1,989,821.86 is the tax due the petitioner (Exh. 4).

Certification, dated December 7, 1990, issued by Revenue Officers Wilfrando Balangue, Paz Asuncion, Jose Salindong, Jr., and Dario Roxas that they conducted physical inventory of the finished products and raw materials of petitioner Fortune Tobacco on November 30, 1990 (Exh. 5).

Letter, dated April 18, 1991, of the Commissioner of Internal Revenue addressed to Atty. Abraham C. La Vina, counsel for the petitioner, denying in effect the request for cancellation and withdrawal of the assessment on the importation of stemmed-leaf tobacco covering the period from July 1, 1989 to November 30, 1990 in the total amount of P1,989,821.86 inclusive of surcharge and interest thereby reiterating his demand for the payment of the deficiency tax (Exh. 7).

With the admission of all the exhibits, as qualified by petitioner, respondent rested its case (Hearing of December 6, 1991, pp. 2-19, TSN).

Respondent filed its memorandum on February 13, 1992 followed by Petitioner on March 5, 1992.

On January 29, 1993, the Court *motu propio*, promulgated a Resolution stating, in effect, that the case not only poses legal issues but also "genuine questions of facts." The Court sought the reopening of the case for the parties to present "additional evidence" on the following matters:

> (a) The nature and circumstances of the importation by petitioner of stemmed leaf tobacco.
>
> (b) Whether the stemmed leaf tobacco in the inventory of petitioner for the period in question was imported directly by petitioner or purchased locally. If in the latter category, was the local purchase from a manufacturer of tobacco products (L-7) or from a wholesale tobacco leaf dealer also known as stripper (L-6).

During the hearing of March 15, 1993 for the reception of "additional evidence", CTA Case No. 4587 involving the same parties and presumably involving similar issues with the instant case, was also considered pursuant to the Resolution of January 29, 1993. The Court was informed of the death of Atty. La Vina, counsel on record of petitioner, with no one taking his place to represent petitioner in said hearing.

Respondent presented one Enrique Z. Bueno, Assistant Chief of the Tobacco Tax Division, BIR. He testified that in 1989 he was assigned to the Field Operations Division which was in charge of investigations relative to payments of excise taxes and inspection of manufacturers of excisable products. The witness further stated that he was one of the Revenue Officers who was assigned to conduct the stock-taking in the factory of the petitioner. The team submitted a Memorandum Report, dated November 21, 1989.

As part of their stock-taking procedure, the team went over the books of the petitioner first. There is a L-7-1/2 official register book where all the tobacco raw materials purchased are entered. The L-7 book records all raw materials and finished products. Both imported and locally grown tobacco are first recorded in the L-7-1/2 record book.

In the memorandum report which witness Bueno stated his team submitted to the Chief of the Field Operations Division, they found and ascertained a total of 38,584,595 kilograms of imported tobacco which was taken from the L-7-1/2 official register. In the same register are also recorded locally grown tobacco, and even such categories as Virginia, Burley, some turkeys (sic) grown in San Jose, Mindoro. The witness concluded his testimony by stating that stemmed leaf tobacco where the midribs are removed either by stripping or by use of a threshing machine is partially manufactured tobacco having been done abroad or from where it came from.

Atty. Rustus V. Raymundo entered his appearance for petitioner on April 30, 1993. During the hearing set anew by the Court on July 15, 1993 for the continuation of the reception of "additional evidence," petitioner's new counsel did not appear. The Court granted respondent's oral motion that petitioner was deemed to have waived its right to cross-examine respondent's witness who testified on March 15, 1993.

Again, another development transpired. Atty. Raymundo withdrew as counsel for petitioner on July 16, 1993 and Atty. Alfonso M. Cruz entered his appearance for petitioner on August 16, 1993. During the hearing set on September 10, 1993 for the same purpose, petitioner's counsel's earlier motion to postpone said hearing was denied and petitioner's right to present additional evidence, if any, was considered waived. The case was then considered submitted anew for decision. Petitioner did not submit supplemental memorandum in spite of the Order of the Court on September 23, 1993.

Despite the dearth of evidence on record, this case can be resolved based on the interpretation of existing laws as to the nature of stemmed-leaf tobacco and whether or not it is subject to excise tax.

Republic Act No. 698 entitled "An Act to Limit the Importation of Foreign Leaf Tobacco" was approved on May 9, 1952. This was amended by Republic Act No. 1194, approved on August 25, 1954. In the amendatory law, new sections were added to R. A. 698, one of which provides:

> "Sec. 1-b. By processed tobacco is meant leaf tobacco which is either blended, cased, flavored, ready-cut, or cut fillers ready for manufacturing purposes, and shall not include tobacco leaf only the stem of which is removed. By Virginia-type leaf tobacco, as used in section 1-a, is meant any kind of tobacco, leaf or scrap, for the manufacture of cigarettes." [underscoring supplied]

Paraphrasing this non-definition of stemmed leaf tobacco (stem removed), it does not fall under the category of "processed tobacco" which, as defined by law, is either blended, cased, flavored, ready-cut or cut-filled for manufacturing purposes.

Section 137 of the National Internal Reveneu Code (NIRC) specifically identifies and mentions stemmed-leaf tobacco as one of the tobacco products which may be removed free of tax (without pre-payment) for agricultural or industrial use. Quoting the provision in full :

> "Section 137. Removal of tobacco products without prepayment of tax. - Products of tobacco entirely unfit for chewing or smoking may be removed free of tax for agricultural or industrial use, under such conditions as may be prescribed in the regulations of the Department of Finance. Stemmed leaf tobacco, fine-cut shorts, the refuse of fine-cut chewing tobacco, scraps, cuttings, clippings, stems or midribs, and sweepings of tobacco may be sold in bulk as raw material by one manufacturer directly to another, without payment of the tax under such conditions as may be prescribed in the regulations of the Department of Finance.
>
> "Stemmed leaf tobacco" as herein used means leaf tobacco which had had the stem or midrib removed. The term does not include broken leaf tobacco." [emphasis supplied]

It need not be emphasized that as provided for in said section, stemmed leaf tobacco may be sold in bulk as raw material by one manufacturer directly to another without the payment of tax. This section itself authorizes a tax exemption under the conditions mentioned therein. Neither does it draw a distinction between imported or locally-grown tobacco.

Respondent anchors its stand that stemmed leaf tobacco, especially if imported, would fall under the category of partially-prepared tobacco with or without the use of any machine or instruments and therefore should be assessed and collected a tax of seventy-five centavos on each kilogram. Section 141 of the NIRC falls under Chapter 4 - Excise Tax on Tobacco Products which provides:

> "Sec. 141. <u>Tobacco Products</u>. - There shall be collected a tax of seventy-five centavos on each kilogram of the following products of tobacco:
>
> (a) Tobacco twisted by hand or reduced into a condition to be consumed in any manner other than 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, cuttings, stems and sweepings of tobacco.
>
> Fine-cut shorts and refuse, scraps, clippings, cuttings, stems and sweepings of tobacco resulting from the handling or stripping of whole leaf tobacco may be transferred, disposed of, or otherwise sold, without prepayment of the specific tax therein provided for under such conditions as may be prescribed in the regulations promulgated by the Secretary of Finance upon recommendation of the Commissioner of the same are to be exported or to be used in the manufacture of other tobacco products on which the excise tax

> will eventually be paid on the finished product.
>
> On tobacco specially prepared for chewing so as to be unsuitable for use in any other manner, on each kilogram, sixty centavos." [emphasis supplied]

We cannot agree to the interpretation of respondent. Stemmed-leaf tobacco, that is, tobacco where the stem or midrib is removed, as identified in R. A. 698, Sec. 1-b and explicitly defined in Section 137 of the NIRC, cannot be considered as tobacco partially prepared/manufactured under Section 141(b) of the NIRC. If it was the intention of the law to include stemmed leaf tobaco as "prepared or partially prepared" which is too well known in the industry and clearly identified in the aforecited provisions of law, it would have specifically said so. It is likewise noted that under Section 141 (b) of the NIRC, where respondent wants stemmed leaf tobacco to be included, this particular class of tobacco as defined is not germane to it. "Manufacturing" presupposes an act of producing something out of raw materials. Stemmed leaf tobacco is a raw material and an essential ingredient in the manufacture of cigarettes (another tobacco product) by which an excise/ad valorem tax will eventually be paid on said finished product. This is in fact bolstered by Section 137 of the NIRC which specifically defines and mentions stemmed leaf tobacco and provides that such product may be sold in bulk as raw material without the payment of tax.

Whether or not stemmed-leaf tobacco is imported or obtained from local sources is of no consequence. There is in fact hardly any difference between the imported and locally-produced Virginia type tobacco used in the manufacture of cigarettes. The provisions of law cited do not draw any distinction. Petitioner meticulously keeps a record of all these tobacco products, whether local or imported, which it needs in the manufacture of cigarettes and registered under one record book (L-7-1/2). If the law does not distinguish, we should not distinguish. *Ubi lex non distinguit nec nos distinguere debemos,* or *"where the law does not distinguish, neither do we distinguish"* (*Colgate-Palmolive Phils. Inc. vs. Gimenez, 1 SCRA 267, citing Lingget and Myers Tobacco Co. vs CIR, 53 Off. Gaz. No. 15, p. 4831*).

It is in fact admitted by respondent that "imported leaf tobacco has never been subjected to tax" in spite of its insistence that stemmed leaf tobacco is "partially manufactured tobacco" and therefore subject to the specific tax of seventy-five centavos (P0.75) per kilogram (Answer, Par. 11).

> *"Generally, revenue laws, such as those imposing taxes and license fees are construed strictly against the taxing power and liberally in favor of the taxpayer. (In re Arbuckle's Estate, 188 A. 758). This is because tax laws operate to impose burdens on the public, or to restrict them in the enjoyment of their property and the pursuit of their occupations. (Alvea - Nichols vs. U.S., 12 F. 2d., 998). Thus, in the interpretation of such statutes, it is the established rule not to extend their provisions by implication, beyond the clear import of the language employed, or to enlarge their scope to include matters not specifically pointed out. In case of doubt, they are construed most strongly against the government. (Gould vs. Gould, 62 L. ed., p. 211)." [Quoted from Martin's Handbook of Statutory Construction, p. 193).*

In view of the foregoing, taking up other issues raised in the pleadings would no longer be material and relevant to the resolution of this case.

WHEREFORE, judgment is hereby rendered setting aside respondent's assessment of P1,989,821.26 as deficiency excise tax from the petitioner. No costs.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

MANUEL K. GRUBA
Associate Judge

CERTIFICATION

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.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals