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Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

PILIPINAS SHELL PETROLEUM
Petitioner,

- versus -

C.T.A. CASE NO. 4780

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
AUG 09 1996

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DECISION

This is a Petition for Review of the denial by the respondent Commissioner of Internal Revenue of petitioner's protest of an assessment issued against petitioner for deficiency surtax on alleged extraordinary gains arising from the oil price increase of August 15, 1987 in the amount of P225,592,198.[83] inclusive of surcharge and interest.

It appears from evidence presented that on August 14, 1987, the Energy Regulatory Board (ERB) issued an order authorizing the three oil companies, Caltex (Philippines) Inc., Petrophil Corporation and Pilipinas Shell Petroleum Corporation, to increase their price of various petroleum products, effective 12:01 A.M. of August 15, 1987.

On account of said price increase on November 10, 1989, petitioner received a letter from BIR Industry Audit Division, inviting petitioner to an informal conference regarding the proposed assessment of a surtax on alleged extraordinary gains realized by petitioner from the August 15, 1987 oil price increase. Pre-assessment Notice, dated April 2, 1990, and eventually an Assessment Letter and Assessment Notice No. FAS-1-87-90-001762 letter, dated May 25, 1990, assessing petitioner for deficiency surtax on alleged extraordinary gains realized by petitioner as a result of the August 15, 1987 oil price increase, were issued as follows:

1987
Surtax on Extraordinary Gains

Total Inventory Gains	**P178,156,951.[14]**
Surtax Due 65%	**115,802,018.[24]**
Add: 25% surcharge	**28,950,504.[55]**
20% interest	
from 8-16-89 to 5-30-90	**80,819,676.[04]**
Total Amount Due and	
Collectible	**P225,572,198.[83]**

Petitioner was given thirty (30) days from receipt of said assessment to pay. On June 01, 1990, petitioner filed its protest letter, dated May 3, 1990, disputing the factual and legal bases of the assessment.

However, on March 24, 1992, petitioner received respondents's letter, dated January 30, 1992, denying petitioner's protest with a repeat request to pay the assessment within fifteen (15) days from receipt of the letter, otherwise, the collection shall be enforced by means of distraint and levy. The respondent Commissioner considered the said denial as his final decision on the matter. Hence, on April 07, 1992, petitioner filed the instant petition for review.

Respondent, in denying the protest invoked Presidential Decree No, 1889 and its implementing Revenue Regulations Nos. 13-84 and 22-84, and imputed the OPSF component of the August 1987 price increase as well as the increase in ad valorem tax as part of the extraordinary gains subject to surtax.

Petitioner, on the other hand, alleged that the price increase representing petitioner's contribution to the Oil Price Stabilization Fund (OPSF) is simply a mechanism for reimbursing cost increases previously incurred by it. Presidential Decree No. 1889 and its implementing revenue regulation are all inapplicable, and even if applicable, its application will not result in extraordinary gain. Furthermore, it alleged that with the operation of Presidential Decree No. 1956 and LOI 1441, "extraordinary gain" under PD 1889 ceased to be possible.

Accordingly, the issue this court is called upon to resolve in this case is:

> **"Whether or not the component of the price increase especially the provisional increase in wholesale posted prices of petroleum products by an average of forty-eight point seven (P.487) centavos per liter plus the resultant average increase of P.0007 per liter in the ad valorem tax, constitute extraordinary gain subject to sixty five (65%) percent surtax pursuant to P.D. 1889."**

The resolution to this issue depends on the interpretation by this Court of the Order of the Energy Regulatory Board of August 14, 1987, in relation to Presidential Decree Nos. 1889 & 1956 and Letter of Instruction No. 1441.

In a similar case involving Caltex (Phils.), Inc. vs. Commissioner of Internal Revenue, CTA Case No. 4711, this Court ruled on the application of Presidential Decree No. 1889, as follows:

> **"Finally, on November 3, 1983, Presidential Decree No. 1889 was issued in the same manner as P.D. 1867, the surtax on extraordinary gain was (increased to) also 65% but unlike the two previous decrees the said "surtax shall be allowed as part of the cost of the petroleum product sold on after November 3, 1983. The computation of extraordinary gain is likewise based on the difference between the wholesale posted prices before and after the price increased multiplied by the number of units of petroleum products**

> existing as of the day of the effectivity of the price increases. The same is likewise payable within 30 days following the promulgation of this decree. The law shall take effect immediately. In implementation of this decree, the BIR issued three Revenue Regulations namely: Revenue Regulation No. 12-84 to implement the June 7, 1984 price increase; Revenue Regulation No. 13-84 to implement price increase on May 18, 1984 and Revenue Regulation No. 22-84 to implement the October 20, 1984 price increase. The computation of extraordinary gain arising from the increase in the industry net back shall be determined on the average by multipying the inventory of petroleum products as of the date of the increase by the authorized price increase per liter while gains due to increase in ad valorem tax shall be determined by multiplying the inventory of unbonded (tax paid) stocks as of the date of the authorized price increase by the increase in ad valorem and/or specific tax increases. The surtax was made payable within thirty (30) days after the date of the effectivity of the price increase. x x x. "However, this is not so in the case of P.D. 1889. When the same was promulgated on November 3, 1983 there were no price increases prior to its promulgation nor was there a recent price increase. The law states that it shall take effect immediately or prospectively. Accordingly, it was made to apply to subsequent price increases the following year 1984 and as mentioned above three revenue regulations were issued in implementation of these price increases that year. The application of said decree to the 1984 price increases is correct by the rules on statutory construction that laws unless otherwise provided shall have prospective effect".

Unlike in the Caltex case, petitioner in this case did not offer a very strong objection on the application of PD 1889 but dwelt more to explain that in view of the existence of two other related laws, namely PD 1956 and LOI 1441, there can be no "extraordinary gain" although increases in the price of petroleum products was authorized by the Energy and Regulatory Board.

On October 15, 1984, Presidential Decree No. 1956 took effect. Under Section 8 thereof, a special account in the General Fund was created and designated as Oil Price Stabilization Fund for the purpose of minimizing frequent price changes brought about by foreign exchange rate adjustments and/or an increase in world market of crude oil and imported petroleum products. The funds are sourced primarily from increase in tax collections on petroleum products. The fund shall be used to reimburse the oil companies for cost increases in the importation of crude oil and petroleum products resulting from exchange rate adjustment and/or increase in world market prices of crude oil.

To implement P.D. 1956, Letter of Instruction No. 1441 was issued by the President on November 20, 1984, the primary purpose of which is to provide a system of periodic review of the price of petroleum products so that the adjustment, if ever made, would require smaller changes so it would be less disruptive to the economy. The LOI mandated the Board of Energy, as follows:

> "(1) To review and reset prices of domestic petroleum products up or down as necessary every two months or the second Monday of the month starting January 14, 1985 to refect the prevailing prices of crude oil and petroleum products;
>
> (2) Our price adjustment shall be made by adjusting the OPSF impost, increasing or decreasing this price component as necessary to maintain a balance between revenues and claims on the OPSF.
>
> (3) The price adjustment shall be made by the Board of Energy on the basis of certified import documents to be submitted by the oil companies and OPSF projection of revenues and claims to be submitted by the Ministry of Energy for this purpose.
>
> (4) This price adjustment shall cover only increases in crude oil and finished product, import cost and shall not include any adjustment for operating and other oil company cost.
>
> (5) This shall not preclude adjustments/restructuring of domestic petroleum product prices by the Board of Energy at any time when necessary in accordance with existing procedures."

Bearing in mind the aforementioned applicable laws involved in this case, we are now ready to examine and analyze the ERB order of August 14, 1987, which states as follows:

> "WHEREFORE, the herein applicants are hereby directed to REDUCE their netback by POINT FIVE (P.005) CENTAVOS average per liter, and authorized to provisionally

INCREASE the wholesale posted prices of their petroleum products by an average of FORTY-EIGHT POINT SEVEN (P0.487) centavos per liter plus thirty-one point one (P0.311) CENTAVOS per liter which applicants are hereby directed to pay to the OPSF. To this total amount of SEVENTY-NINE POINT THREE (P0.793) CENTAVOS shall be added the resultant increase of P.007 per liter average on the Ad Valorem tax adverted to above.

Of this total increase of EIGHTY (P0.80) CENTAVOS per liter which shall be reflected in the retail prices, 48.7 centavos have previously been allocated among the various petroleum products under BOI Resolutions Nos. 87-02 and 87-03 for purposes of reimbursement from the OPSF although not reflected in the retail prices. This Order, therefore, allocates only 31.1 centavos per liter and the point five (P.005) centavos per liter netback reduction among all petroleum products marketed locally in the following manner:

	NETBACK	OIL PRICE STABILIZATION FUND
Premium Gasoline	.02	.4373
Regular Gasoline	.01	.8366
Avturbo	(.078)	-
Kerosene	(.13)	.5343
Diesel Oil	.08	.5499
Fuel Oil	(.067)	-
Feedstock	(.067)	-
LPG	.06	.6018
Asphalts	(.07)	.5296
Thinners/Solvents	(.12)	.5182

"The amount of P.007 representing the ad valorem tax effect "allocates itself"

among the petroleum products upon the application of the ad valorem tax rates. xxx"

By literal interpretations of the order, without sufficient background and explanation as to the mechanics of an oil price hike, the component of the above price increase are as follows:

Company net back	- (P.005) centavos average per liter
Wholesale posted Price	- 0.487 centavos per liter
Oil Price Stabilization Fund	- P0.311 centavos per liter
Ad Valorem Tax	- P.007 centavos per liter average

Applying Presidential Decree No. 1889 and the implementing revenue regulation, we have come up with a computation of extraordinary gains by the difference between the old wholesale posted price and new wholesale posted price plus gain arising from the increases in specific or ad valorem tax, multiplied by the inventory of petroleum products and unbonded stocks, respectively as of the date of the new authorization for price increase. Hence, the pump increase of P.487 centavos and increase in ad valorem of P.007 centavos were multiplied with the existing inventory to arrive at extraordinary gain. This is how we interpreted the said order in the Caltex case.

However, unlike in the Caltex case, where the contending parties merely submitted their own self-serving interpretation of the laws, petitioner in the present case submitted sufficient documentary and testimonial evidence during the hearings to further explain the mechanics of the oil price increase and the so-called extraordinary gain resulting therefrom.

Foremost of which were the testimonies of the Chairman of the Energy Regulatory Board, (ERB), Rex Tantiongco, and the Director of Finance Management Services of the Department of Energy, Cesar Ramirez.

When confronted with a question whether or not, Mr. Tantiongco is familiar with Presidential Decree No. 1889, he answered that he is familiar with the decree because as an officer of the ERB, he participated in the computation of the windfall profit tax slapped by the BIR on the oil companies. He continued with his testimony as follows:

> "A. P.D. 1889 was issued precisely to slap the oil companies with the windfall tax they realized or they gained in the adjustment of petroleum products during that time. But this time, the increase or decrease or any adjustment in the pump price of petroleum products or on the wholesale posted price of petroleum products does not go to the oil companies but reflected in the balance of the OPSF or the OPSF contributions. x x x The netback or the company pay in the

> producers price is affected only by the bi-monthly review and the bi-monthly is precisely only to reflect the adjustment in the cost of importation of crude oil.: (T.S.N. pp. 91-92, January 9, 1995 hearing)

To explain further his point, Mr. Tantiongco testified that before the introduction of the OPSF on October 15, 1984 by Presidential Decree No. 1956, it is possible for the oil companies to get windfall profit because increase in prices are calculated based on the lowest inventory of the oil companies and the effectivity of the increase approximate that period. The oil companies will be realizing gain because the products they are selling then was out of the crude imported in previous period which was at low price. However, it is different after the effectivity of PD 1956 and the subsequent issuance of LOI 1441 on November 20, 1984 (T.S.N. pp. 76-77 January 9, 1995). In an answer to the question why oil companies may no longer realize windfall profits in the context of P.D. 1889 after the establishment of the OPSF, Mr. Tantiongco states as follows:

> "A. Because the adjustment in the netback now is based on their actual importation. So the Energy Regulatory Board gathered all the documents from the Bureau of Customs, from the Department of the Energy which approves the importation of the oil companies and at the same time from the submission of the oil companies together with their documents or receipts they received from the Bureau of Customs.

So the netback is adjusted based on the actual cost of the importation. And whatever adjustment in the pump price is reflected only on the OPSF and not in the netback of the oil companies. Although that adjustment is reflected in the wholesale posted price, the composition of the wholesale posted price is OPSF, tax and netback. So the adjustment on the whole posted price whether upward or downward after the OPSF is created is directly absorbed by the Oil Price Stabilization Fund. (T.S.N. January 9, 1995, pp. 78 to 79.)"

Chairman Tantiongco, further testified that on July 14, 1987, the OPSF contribution was a negative 778.8 million. So the Board increased the price of petroleum product by P.80 centavos per liter. Of this P.80 centavos, P.798 centavos went to OPSF, P.007 centavos went to tax and the netback of the oil companies went down by P.005 centavos/per liter. This statement was further supported by the testimony of Mr. Cesar Ramirez of the Department of Energy, the agency tasked with administering the OPSF. When asked about the components of the 80 centavos increase, he state thus:

"A. Actually there are three components. First is the 79.08 centavos which was allocated and directed to be contributed to the OPSF. This is allocated for purposes of wiping out the deficit in the OPSF averaging 48.7 centavos because at that time the OPSF was already with a negative balance. So there was increases, cost increases that was not reflected in the WPP. So the 48.7 centavos was the average amount which has to be reimbursed to the oil companies and

> also there is, the other 31.1 centavos which will be used also to reimburse the oil companies to the accumulating outstanding claims up to August 1987 and also after the deficit shall have been wipe out, the 31.1 will be able to augment or built up the fund for the future, whatever future increases that may occur later. And also the second was the reduction in netback by .005 centavos and the third one is the increase in the ad valorem tax by .007 centavos. So that is the component of the 80 centavos increase in the wholesale posted price." (T.S.N. pp. 14-15 March 19, 1993).

Mr. Ramirez likewise corroborated the testimony of Chairman Tantiongco, when asked the question whether the withdrawal by the oil companies constitutes a gain, that the withdrawals from OFSF is a mere recovery of the landed cost of crude oil due to increases in the price of crude oil and fluctuation of the exchange rate. (T.S.N. March 13, 1993, p. 11 and Exhibit "M" pp. 18 to 19).

From the above testimonies of the very officials who are involved in the authorization of the oil price increase and in the implementation of the mechanics of the OPSF, it is clear that the WPP amounting to P.487 centavos per liter was part of the OPSF and was ordered to be paid directly to the oil companies to satisfy their claim for reimbursement as the fund was already in deficit and there was nothing more to draw or squeeze out of the fund. We concur with the petitioner that the change in procedure for claiming reimbursement does not change the nature of the funds and should not in any way prejudice the petitioner.

The above testimonies explain the procedure taken by the Board in authorizing the August 15, 1987 price increase as recited in the body of the order. First of all, the Board limited the scope of the proceedings to the alleged increase in the price of crude oil and the peso-dollar exchange rate. The proceeding took into consideration the increase cost of crude importation incurred by the applicants during the period from March to June 1987, as compared to the cost of crude importations prevailing during the period January to February 1987. Taking into consideration our weighted average increase of P1.122 per barrel, or P0.007 per liter of product during the said period, the increase of P0.007 per liter should have been considered in the upward adjustments but the Board of Energy deemed it best not to disturbed the pump price and just let the oil company absorb the said P0.007 per liter cost differential. After a change in the manner of computing customs duty and some offsetting, underrecovery was reduced by P0.005 per liter and finally P0.002 per liter but nothing was done to adjust the pump price. Under the circumstances, the remedy would be to allow the oil companies to withdraw from the OPSF, if and only to the extent that there is sufficient and available amount in the OPSF. As of July 14, 1987, the per liter recovery of the oil companies was reduced from 72.1 to 48.7 centavos per liter after the President issued Executive Order No. 195 reducing the taxes on petroleum products.

This explains the components of this average wholesale posted price prior to the price increase, in peso per liter:

Company Netback	Advalorem	OPSF =	WPP
3.332	1.438	(.487)=	4.283

So, inasmuch as there are no more funds in the OPSF out of which the claim of the oil companies could be satisfied, the said 48.7 /liter should be added in the WPP and the oil companies should be allowed to directly recover from it. This accounted for the change in procedure and explains the allowance of direct recovery by the oil companies in the amount of P48.7 centavos per liter.

However, the 48.7 centavos was not enough, the resulting outstanding obligation of the OPSF will still be approximately P650 million by August 15, 1987 and will have to be recovered by an additional contribution to the fund estimated at 31.1 centavos per liter, averaged. (Order of August 14, 1987, pp. 21-22). This in turn explains the order of the ERB allowing P.487 centavos per liter increase plus P.311 centavos per liter to the OPSF.

All the foregoing, especially including the testimonies of the officials of the agencies of the government incharge of implementing the very order and subject matter of this case, hold firmly to the fact that no extraordinary gain was derived by the petitioner by virtue of the price order of the ERB on August 14, 1987 insofar as the OPSF portion is concerned:

> "It is a principle too well established to require extensive documentation that the construction given to a statute by an administrative agency charged with the interpretation and application of that statute is entitled to great respect and should be accorded great weight by the courts, unless such construction is clearly shown to be sharp conflict with the governing statute or the constitution and other laws. x x x. The rationale for this rule relates not only to the emergence of the multifarious needs of a modern or modernizing society and the establishment of diverse administrative agencies for addressing and satisfying those needs; it also relates to accumulation of experience and growth of specialized capabilities by the administrative agency charged with implementing a particular statute. In closing, it is useful to remind litigation

> prone individuals that the interpretation by officers of laws which are entrusted to their administration is entitled to great respect. The construction of the office charged with implementing the provisions of a statute should be given controlling weight." (Nestle Philippines, Inc. vs. Court of Appeals and Securities & Exchange Commission, 203 SCRA 504 (November 13, 1991.); Siera Madre Trust versus Secretary of Agriculture & Natural Resources, 121 SCRA 384 (April 20, 1983); Asturias Sugar Control, Inc. versus Commissioner of Customs, 29 SCRA 617 (September 30, 1989.)

x x x x x x x x x

However, the same conclusion may not be true with regard to the increase in the ad valorem tax by an average of P.007 centavos per liter of petroleum products. The respondent is correct in assessing petitioner for 65% surtax on extraordinary gain covering tax paid petroleum products because the taxes on those products have already been paid at the old rate as required by law and when sold at the higher pump price petitioner certainly benefited by the increase in ad valorem tax. The increase in ad valorem tax goes to the petitioner as the law requires payment of the tax within fifteen (15) days from the date of removal of petroleum products from the place of production (Section 127 (a) National Internal Revenue Code). These stocks are stored in unbonded installations or depots ready for marketing and are not subjected again to the payment of the higher tax rate. To the extent of this unbonded or tax paid stocks, this Court believes petitioner is liable to 65% surtax for extraordinary gain pursuant to PD 1889. In fact, petitioner failed to dispute this finding of the respondent.

Accordingly, the assessment against petitioner for surtax on windfall profit or extraordinary gain is recomputed as follows:

1. Due to the increase in the Oil Price Stabilization Fund, deleted.

2. Due to tax paid inventory of petroleum products.

ITEM	INVENTORY
Premium Gas	P18,452,288.^{00}
Regular Gas	11,810,756.$_{00}$
Kerosene	9,968,741.^{00}
Diesolie	46,046,147.^{00}
Fuel Oil	35,164,191.^{00}
Avturbo	2,896,826.^{00}
Solvents	441,039.^{00}
LPG	6,144,471.00
Total	130,924,464.^{00}
Multiply by average rate of increase in Ad Valorem Tax	x P0.007
	916,471.^{25}
Multiply by rate of Surtax	x 65%
	P595,706.^{31}
Add 25% surcharge	148,926.57
	P744,632.^{88}

*plus 20% interest from date prescribed for payment which is within thirty (30) days after August 15, 1989, the effectivity date of the price increase, until the amount is fully paid pursuant to Section 249 of the NIRC.

Wherefore, in view of all the foregoing, the assessment is hereby modified. Petitioner is ordered to pay respondent the total amount of P744,632.[ee] representing surtax on extraordinary gain, inclusive of the 25% surcharge plus 20% interest from August 15, 1987, until fully paid.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

I CONCUR:

ERNESTO D. ACOSTA

CERTIFICATION

I hereby certify that this decision was reached after due consultation with 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