REPUBLIC OF THE PHILIPPINES
**Court of Tax Appeals**
QUEZON CITY

## *SECOND DIVISION*

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| **CONTINENTAL LEAF TOBACCO (PHIL.), INC.,** Petitioner, | **C.T.A. CASE NO. 7414** |
| | Members: |
| - versus - | **CASTAÑEDA, JR.,** *Chairperson* **UY,** *and* **PALANCA-ENRIQUEZ,** *JJ.* |
| **COMMISSIONER OF INTERNAL REVENUE,** Respondent. | **Promulgated:** NOV 27 2008 2:00 p.m. |

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# DECISION

**UY, *J.*:**

The instant Petition for Review with the Supplement to the Petition for Review filed by petitioner, Continental Leaf Tobacco (Phil.), Inc., on February 23, 2006 and June 23, 2006, respectively, seeks the cancellation of the assessment for deficiency excise taxes on the removals of stemmed leaf tobacco from its premises issued by respondent, Commissioner of Internal Revenue, against the former for taxable years 2002, 2003 and the months of January to March of 2004, in the aggregate amount of **FIFTEEN MILLION FOUR HUNDRED EIGHTY SEVEN THOUSAND FORTY SEVEN AND 6/100**

**PESOS (P15,487,047.06)**, inclusive of increments.[1]

## THE FACTS

Culled from the records of this case, and as stipulated by the parties in their Joint Stipulation of Facts and Issues,[2] these are the facts of the case.

Petitioner is a corporation duly organized and existing under and by virtue of Philippines laws, with principal office at Barrio Bulala, Bacnotan, La Union.

Respondent, on the other hand, is the official of the Bureau of Internal Revenue (BIR) charged with the duty of assessing and collecting internal revenue taxes.

On November 3, 2004, petitioner received a Preliminary Assessment Notice (PAN) dated September 28, 2004 for alleged deficiency excise taxes on partially manufactured tobacco for the years 2002, 2003 and the months of January to March 2004 in the amount of P18,860,355.38.[3] The assessment came about when petitioner removed 13,143,426 kilograms of stemmed leaf tobacco during the said period.

On May 30, 2005, petitioner received a Formal Letter of Demand dated May 16, 2005 for alleged deficiency excise taxes on partially manufactured tobacco for the years 2002, 2003 and the months of January to March 2004 in the amount of P16,845,883.94. The basis for such assessment was Section 144 of the National Internal Revenue Code (NIRC) of 1997.[4]

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[1] As contained in the Final Decision on Disputed Assessment dated April 5, 2006; Exhibit "F", Docket, pp. 268-271.
[2] Docket, pp. 183-187.
[3] Exhibit "A", Docket, pp. 216-218.
[4] Exhibit "C", Docket, pp. 236-239.

Petitioner filed its Letter of Protest[5] on June 16, 2005 and a Supplement to Protest[6] on August 10, 2005.

Respondent did not act on the Protest and Supplement to Protest despite the lapse of one hundred eighty (180) days from receipt of the Supplement to Protest. Hence, due to said inaction, petitioner filed a Petition for Review with this Court on February 23, 2006 in accordance with Section 228 of the NIRC of 1997.

Subsequently, on May 10, 2006, petitioner received a "Final Decision on Disputed Assessment" dated April 5, 2006 signed by Merlinda L. Ordoyo, OIC-Large Taxpayers Service, embodying the "Final Decision on Disputed Assessment" of the BIR that has been the subject of this proceeding, which has further reduced the amount being assessed against petitioner to P15,487,047.06, inclusive of increments.[7]

Consequently, petitioner filed a "Motion for Leave to File Supplement to Petition for Review and to Transfer Date of Pre-trial" and a "Manifestation with Motion for Additional Time to File Supplement Petition for Review" on June 2, 2006[8] and June 9, 2006,[9] respectively, both of which were granted in a Resolution dated July 3, 2006. As petitioner already filed its Supplement to the Petition for Review on June 23, 2006, praying for the cancellation of the assessment in the original amount of P16,845,883.94 and/or in the reduced amount of P15,487,047.06, for alleged deficiency excise taxes on petitioner's

[5] Exhibit "D", Docket, pp. 240-260.
[6] Exhibit "E", Docket, pp. 261-267.
[7] Exhibit "F", Docket, pp. 268-271.
[8] Docket, pp. 102-110.
[9] Docket, pp. 116-120.

removals of its stemmed leaf tobacco from its premises,[10] the Court considered the same as part of the records of this case and the original answer filed by respondent on May 5, 2006 served as the answer thereto.[11]

In the aforesaid Answer[12], respondent raised the Special and Affirmative Defenses, to wit:

> "16. On 16 June 2005, petitioner promptly filed its protest against the Formal Letter of Demand/ Final Assessment Notice, duly issued by respondent, covering deficiency Excise taxes in the aggregate amount of P16,845,883.94 for taxable years 2002, 2003 and the months of January to March 2004;
>
> 17. On 10 August 2005, petitioner filed a supplement to its protest;
>
> 18. There being no decision on the protest up to this date, petitioner made an election and chose to elevate its case to the Honorable Court from the lapse of 180 days from filing of its protest. Presumably, this election is in consonance with the option provided in Section 3 (a) (2) of the Revised Rules of the Court of Tax Appeals;
>
> 19. Having made an election, petitioner is bound by the provisions of Section 228 of the Tax Code of 1997, which provides:
>
>> '**SEC. 228. Protesting of Assessment. –**
>> x x x
>>
>> Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.
>>
>> **If the protest is denied in whole or in part, or is not acted upon within one hundred**

[10] Docket, pp. 121-130.
[11] Ibid.
[12] Docket, pp. 82-93.

> **eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of one hundred eighty (180)-day period**; otherwise, the decision shall become final, executory and demandable.' (emphasis supplied)

Thus, petitioner is bound to elevate its case within thirty (30) days from the lapse of the 180-day period counted, either, from filing its formal protest, or submission of supporting documents within the period allowed;

20. Except for a supplement to its protest, no supporting documents were submitted in its administrative protest. Hence, the 180-day period in this case is reckoned from the date of petitioner's filing of its protest, or on 16 June 2005.

21. After electing to elevate its case based on inaction of the respondent, herein petitioner filed its petition before the Honorable Court on 23 February 2006 or after a lapse of 252 days. Obviously, this is beyond the period prescribed which is, **thirty (30) days from receipt of the said decision, or from the lapse of one hundred eighty (180)-day period** as provided in Section 228 of the Tax Code of 1997.

22. Having been filed out of time, consequently, as provided in the same section, the deemed denial of the protest 'shall become final, executory and demandable'.

23. By explicit provision of law, the omission of petitioner to file its petition within the thirty (30) day period prescribed by law, after electing to contest the deemed denial after 180 days from filing of its protest, has rendered the assessment final, executory and demandable, and as such it can no longer be disputed either administratively or judicially;"[13]

During trial, only petitioner presented testimonial and documentary evidence in support of its position. Respondent, however, waived the right to present evidence and submitted the case for decision.[14]

[13] Ibid., at pp. 89-90.
[14] Transcript of Stenographic Notes (TSN), October 17, 2007, p. 3.

On January 14, 2008, a Resolution[15] was issued submitting the case for decision taking into consideration the Memoranda filed by petitioner and respondent on November 16, 2007 and December 19, 2007, respectively.

Hence, this Decision.

**THE ISSUES**

As stipulated by the parties, the issues for this Court's consideration are as follows:

1. Whether petitioner is an L-7 licensee.
2. Whether the subject tobacco is unmanufactured tobacco.
3. Whether the subject tobacco is subject to excise tax.
4. Whether Revenue Regulations Nos. V-39 and 17-67 are valid.
    a. Whether Section 20(A) of Revenue Regulations No. V-39 limits the class of manufacturers whose sales of stemmed leaf tobacco are exempt from prepayment of specific tax.
    b. Whether respondent, in issuing Revenue Regulations No. 17-67 that purported to limit the manufacturers that were exempt from excise tax, exceeded on constitutional grounds the limits on delegation of legislative power.
    c. Whether Section 2(m) of Revenue Regulations No. 17-67 exceeded on constitutional grounds the limits on delegation of legislative power.
5. Whether respondent's interpretation of Revenue Regulations No. 17-67 is supported by the BIR's administrative practice and BIR Ruling dated December 12, 1972.
6. Whether the assessment for petitioner's alleged deficiency taxes for taxable years 2002, 2003 and the months of January to March 2004 is valid.

[15] Docket, p. 353.

The aforequoted issues may be summed up into one issue, to wit: whether or not stemmed leaf tobacco may be sold without prepayment of excise tax from one manufacturer to another.

## THE COURT'S RULING

The core issue presented before this Court is not novel.

The excise tax on certain tobacco products is provided in Section 144 of the NIRC of 1997, as follows:

> "**SEC. 144.** *Tobacco Products.* - There shall be collected a tax of seventy-five centavos (P0.75) 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 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, 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 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 other manner, on each kilogram, Sixty centavos (P0.60)."

Under Section 140 of the NIRC of 1997, however, some tobacco products may be sold without prepayment of the excise tax subject to certain conditions, to wit:

> "**SEC. 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 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 rules and regulations prescribed by the Secretary of Finance.
>
> '**Stemmed leaf tobacco**,' as herein used, means leaf tobacco which has had the stem or midrib removed. The term does not include broken leaf tobacco."

Moreover, Section 20 of Revenue Regulations No. V-39, which specifically lays down the rules for tax exemption on tobacco products, states:

> "**Section 20.** *Exemption from tax of tobacco products intended for agricultural or industrial purposes.* — (a) Sale of stemmed leaf tobacco, etc., by one factory to another. — Subject to the limitations herein established, products of tobacco entirely unfit for chewing or smoking may be removed free of tax for agricultural or industrial use; and stemmed leaf tobacco, fine-cut shorts, the refuse of fine-cut chewing tobacco, refuse, scraps, cuttings, clippings, and sweeping of tobacco may be sold in bulk as raw materials by one manufacturer directly to another without the prepayment of the specific tax.
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> **Stemmed leaf tobacco**, fine-cut shorts, the refuse of fine-cut chewing tobacco, scraps, cutting, clippings, and sweeping of leaf tobacco or partially manufactured tobacco or other refuse of tobacco may be transferred from one factory to another under an **official L-7 invoice** on which shall be entered the exact weight of the tobacco at the time of its removal, and entry shall be made in the **L-7 register** in the place provided on the page for removals. Corresponding debit entry will be made in the L-7 register book of the factory receiving the tobacco under heading "Refuse, etc., received from other factory", showing date of receipt, assessment and invoice numbers,

name and address of the consignor, form in which received, and the net weight of the tobacco. xxx" (*Emphasis Ours*)

In relation thereto, Section 2(m)(1) of Revenue Regulations No. 17-67 defines "partially manufactured tobacco" as including "stemmed leaf tobacco". To quote:

"**Section 2.** *Definition of terms*

xxx xxx xxx

(m) **Partially manufactured tobacco** – includes:

(1) **Stemmed leaf** – handstripped tobacco, clean, good, partially broken leaf only, free from mold and dust."

Section 3(h) of the same regulations describes who are L-7, as follows:

"**Section 3.**

xxx xxx xxx

(h) L-7 – Manufacturers of tobacco products. xxx"

Petitioner now argues that Revenue Regulations Nos. V-39 and 17-67 are not valid because: (a) Section 20 of Revenue Regulations No. V-39 did not limit the class of tobacco manufacturers whose sales of stemmed leaf tobacco were exempt from prepayment of excise tax; (b) assuming *arguendo* that Section 3 of Revenue Regulations No. 17-67 was intended to limit the class of manufacturers exempt from the prepayment of the specific tax, this would cause it to exceed, on constitutional grounds, the limits on the delegation of legislative power; and (c) Section 2(m) of Revenue Regulations No. 17-67 exceeded, on constitutional grounds, the allowable limits on the delegation of power.

Such arguments will not prosper.

In the case of ***Compania General de Tabacos de Filipinas vs. Court of Appeals, et al.***[16], the Supreme Court had occasion to rule on this particular issue, and in fact reiterated in ***Commissioner of Internal Revenue vs. La Suerte Cigar and Cigarette Factory, Inc.***[17], that:

> "Section 20 (of Revenue Regulations No. V-39) must be construed in relation to Section 2(m)(1) of Revenue Regulations No. 17-67, which classifies stemmed leaf tobacco as 'partially manufactured tobacco', and Section 3 thereof which provides for the different designations for persons dealing with tobacco, to wit: L-3, L-4, L-6, L-7, etc. Section 3(h) of Revenue Regulations No. 17-67 describes an L-7 as a 'manufacturer of tobacco products'."

The Supreme Court further explained the foregoing in the following manner:

> "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 Section 244) of the Tax Code. The authority of the Secretary of Finance, in conjunction with the Commissioner of Internal Revenue, to promulgate needful rules and regulations for the effective enforcement of 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 Sections 137 (now 140) 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 specific tax."

Based on the foregoing jurisprudence, Revenue Regulations Nos. V-39 and 17-67 are valid for they have been issued by the Bureau of Internal Revenue without transgressing the limits on the delegation of legislative power. It is now well-settled that delegation of legislative power to various

[16] G.R. No. 147361, March 23, 2004.
[17] G.R. No. 139803, September 2, 2005.

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specialized administrative agencies is allowed in the face of increasing complexity of modern life. Given the volume and variety of interactions involving the members of today's society, it is doubtful if the legislature can promulgate laws dealing with the minute aspects of everyday life. Hence, the need to delegate to administrative bodies, as the principal agencies tasked to execute laws with respect to their specialized fields, the authority to promulgate rules and regulations to implement a given statute and effectuate its policies. All that is required for the valid exercise of this power of subordinate legislation is that the regulation must be germane to the objects and purposes of the law; and that the regulation be not in contradiction to, but in conformity with, the standards prescribed by the law.[18]

Now that the validity of Revenue Regulations Nos. V-39 and 17-67 has been upheld, the same may be applied in resolving the main issue in the case at bench.

There is no dispute here that the tobacco involved in the present case is stemmed leaf tobacco. Petitioner argues that "stemmed leaf tobacco" is not "partially manufactured tobacco" because the same has not undergone any processing except drying and removal of the lamina (or midrib) and that no additives or preservatives were added thereto.[19]

Petitioner's argument is erroneous. Section 2(m)(1) of Revenue Regulations No. 17-67, implementing Section 140 of the NIRC of 1997, provides that "partially manufactured tobacco" includes "stemmed leaf". Thus, petitioner's stemmed leaf tobacco is "partially manufactured tobacco".

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[18] Equi-Asia Placement, Inc. vs. Department of Foreign Affairs, G.R. No. 152214, September 19, 2006.
[19] Exhibit "H", p. 5; Docket, p. 280.

Consequently, such stemmed leaf tobacco is subject to excise tax under Section 144(b) of the NIRC of 1997.

As to whether the removal of stemmed leaf tobacco is tax-exempt or not, Section 140 of the NIRC of 1997 qualifies the term "manufacturer" by the phrase "under such conditions as may be prescribed in the regulations of the Department of Finance". Under Section 20 of Revenue Regulations No. V-39, the term "manufacturer" refers only to L-7 category of manufacturer.[20] The following conditions must be met for stemmed leaf tobacco to be transferred without prepayment of specific tax:

(a) The transfer shall be made pursuant to 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; and

(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.[21]

In this case, petitioner did not present any evidence that it has been categorized as L-7 manufacturer. Thus, petitioner's removal of stemmed leaf tobacco is not exempt from excise tax.

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[20] Commissioner of Internal Revenue vs. La Campana Fabrica de Tabacos, Inc., G.R. No. 145275, November 15, 2001.

[21] Ibid.

The contention that subjecting stemmed leaf tobacco to excise tax runs counter the BIR's administrative practice and BIR Ruling dated December 12, 1972 is erroneous. In ***Abello, et al. vs. Commissioner of Internal Revenue***[22], the Supreme Court ruled that the BIR is not precluded from making a new interpretation of the law, especially when the old interpretation was flawed. The Court elucidated that:

> "xxx erroneous application and enforcement of the law by public officers do not block subsequent correct application of the statute *(PLDT v. Collector of Internal Revenue, 90 Phil. 676)*, and that the Government is never estopped by mistake or error on the part of its agents *(Pineda v. Court of First Instance of Tayabas, 52 Phil. 803, 807; Benguet Consolidated Mining Co. v. Pineda, 98 Phil. 711, 724)*."

Respondent's power to revoke any previous ruling is not without any legal basis. Section 7 of the NIRC of 1997 provides:

> "**Section 7. -** *Authority of the Commissioner to Delegate Power.* - The Commissioner may delegate the powers vested in him under the pertinent provisions of this Code to any or such subordinate officials with the rank equivalent to a division chief or higher, subject to such limitations and restrictions as may be imposed under rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner: *Provided, however,* That the following powers of the Commissioner shall not be delegated:
>
> (a) The power to recommend the promulgation of rules and regulations by the Secretary of Finance;
>
> (b) The power to issue rulings of first impression or **to reverse, revoke or modify any existing ruling of the Bureau**;
>
> xxx." (*Emphasis Ours*)

[22] G.R. No. 120721, February 23, 2005.

Applying the foregoing discussion and based on the existing provisions of law and jurisprudence, petitioner cannot bank on a previous ruling of the BIR in the absence of any evidence in which the same is still being upheld.

In sum, petitioner is liable for the deficiency excise tax which arose from its removal of stemmed leaf tobacco.

**WHEREFORE**, premises considered, the Petition for Review is hereby **DISMISSED** for lack of merit. Accordingly, petitioner is hereby **ORDERED to PAY** respondent the amount of P15,487,047.06, representing deficiency excise taxes for the years 2002, 2003 and the months of January to March 2004, plus twenty percent (20%) delinquency interest *per annum*, pursuant to Section 249 of the NIRC of 1997, commencing from May 10, 2006[23] until full payment thereof.

**SO ORDERED.**

**ERLINDA P. UY**
Associate Justice

WE CONCUR:

**JUANITO C. CASTAÑEDA, JR.**
Associate Justice

**OLGA PALANCA-ENRIQUEZ**
Associate Justice

[23] Date petitioner received the subject Final Decision on Disputed Assessment as admitted and contained in paragraph A.10 of the Joint Stipulation of Facts and Issues, Docket, p. 185.

## ATTESTATION

I attest that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

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

## CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

**ERNESTO D. ACOSTA**
Presiding Justice