REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

3M PHILIPPINES, INC.,
Petitioner,

- versus - C.T.A. CASE NO. 3824

COMMISSIONER OF INTERNAL REVENUE,
Respondent.
x - - - - - - - - - - - - x

8/18/87

D E C I S I O N

This is an appeal from the decision of respondent Commissioner of Internal Revenue holding petitioner liable for the amounts of ₱216,790.37 and ₱9,355.41, or a total sum of ₱226,145.78, as deficiency sales and contractor's taxes, respectively, for the period from November 1, 1974 to October 31, 1975.

Petitioner 3M Philippines, Inc. is a domestic corporation engaged in the business as an importer, wholesaler and exclusive manufacturer of 3M brand products such as abrasive, adhesives, reflectorized traffic signs, medical and electrical supplies, and cassette tapes. It is also engaged in the leasing and servicing of duplicating machines. While petitioner is the sole dealer of 3M brand photocopying machines, it has also other units of photocopying machines for lease, with exclusive contracts for the servicing and maintenance of the said units. (pp. 45-46, BIR rec.)

In the investigation conducted by the BIR examiners, it was disclosed that, for the period from November 1, 1974 to October 31, 1975, petitioner is liable for deficiency contractor's tax due from rental and service income of photocopying machines.

Likewise, it was also the finding of the examiners that, under Section 185-B(g) of the Old National Internal Revenue Code, the manufacture and sale of cassette tapes is taxed at 40% and since the imported raw materials used in the manufacture thereof as finished articles are also subject to 40% advance sales tax, the allocable portion of allowable raw materials used in the manufacture of the aforesaid article are considered as deduction in arriving at the net taxable sales. (p. 45, BIR rec.)

On the basis of the BIR findings, the corresponding deficiency assessment, computed herein below (p. 49, BIR rec.), was issued against petitioner.

Def. sales tax per investigation . . .	₱101,248.29	
25% surcharge	25,312.07	
	₱126,560.36	
14% int. fr. 1/21/76 - 7/31/80 . . .	80,267.01	
20% int. fr. 8/1/80 - 12/22/80 . . .	9,963.00	- ₱216,790.37

Def. percentage tax per investigation . . .	₱ 4,369.30	
25% surcharge	1,092.32	
	₱ 5,461.62	
14% int. fr. 1/21/76 - 7/31/80	3,463.86	
20% int. fr. 8/1/80 - 12/22/80	429.93	- ₱ 9,355.41
Total Amount Due and Collectible		₱226,145.78

In a letter dated February 28, 1981, petitioner protested the assessment contending, among others, that Section 185-B(g) of the Old Tax Code does not include cassette tapes within its purview as said section refers to machines, instruments, and devices which are capable of recording or reproducing sound or music and cassette tape is neither a machine, instrument and device, hence, not subject to 40% sales tax, but to 7% sales tax as an ordinary article, under Section 186 of the said Old Tax Code. It was further contended that the deficiency contractor's tax assessment arose because the BIR examiners included the sales for the past period, the applicable tax on which had already been paid. (pp. 53-55, BIR rec.)

The protest of petitioner was finally denied by respondent in his letter-decision dated April 18, 1983. Hence, this appeal.

The issues sought to be resolved by the parties may be stated as follows:

1. Whether the blank cassette tapes manufactured and sold by petitioner from November 1, 1974 to October 31, 1975 are subject to 40% sales tax as sound reproducing or recording articles under Section 185 or 185-B(g) of the Old Tax Code, or 7% sales tax as ordinary articles under Section 186 of the same Tax Code; and

2. Whether or not the imposition of the deficiency 3% contractor's tax under Section 191 of the Old Tax Code against petitioner for the same period is proper.

The pertinent provision of law covering the deficiency sales and contractor's percentage taxes for the fiscal year from November 1, 1974 to October 31, 1975 are Sections 185, 185(d), 185(g), 185-B(g) and 186 of the Old Tax Code, as amended by Republic Act No. 6110 and P.D. No. 69, and Section 183(a) of the same Code, which are quoted herein below, respectively, as follows:

"Sec. 185. Percentage tax on sales of sporting goods, and others. There shall be levied, assessed, and collected once only on every original sales, barter, exchange, or similar transaction intended to transfer ownership of, or title to, the articles hereinbelow enumerated, a tax equivalent to forty per centum of the gross value in money of the articles so sold, bartered, exchanged or transferred, such tax to be paid by the manufacturer or producer: Provided, That where the articles enumerated hereinbelow are manufactured out of materials subject to tax under this section, the total cost of such materials, as duly established, shall be deductible from the gross selling price or gross value in money of such manufactured articles.

xxx xxx xxx

(d) Articles of which celluloid is the component material of chief value;

xxx xxx xxx

(g) Pianos; phonograph records (except those locally manufactured and those used for educational purposes); juke boxes;

Sec. 185-B. Percentage tax on sales of phonographs, combination radio and phonograph sets of all types, television sets, combination radio and television sets, combination radio-phonograph-television sets, gramophones, and similar articles.- There shall be levied, assessed and collected once only on every original sale, barter, exchange, or similar transaction intended to transfer ownership of, or title to, the articles hereinbelow enumerated a tax equivalent to forty per centum of the gross selling price or gross value in money of the articles so sold, bartered, exchanged or transferred, such tax to be paid by the manufacturer or producer: Provided, however, That where the articles hereinbelow enumerated are locally manufactured articles as hereinafter defined, the tax shall be seven per centum: Provided further, That where the articles enumerated hereinbelow are manufactured from materials subject to tax under this Section the total cost of such materials shall be deducted from the gross selling price or gross value in money of such manufactured articles:

(a) Phonographs;
(b) Combination radio and phonograph sets of all types;
(c) Television sets;
(d) Combination radio and television sets;
(e) Combination radio-phonograph-television sets;
(f) Gramophones; and
(g) Similar articles for reproducing and/or recording music and sound, like tape recorders, etc.

The words "locally manufactured articles" mean articles manufactured in a manufacturing enterprise which process physically and/or chemically raw materials such as copper clad boards, silicon, steel laminations, other metal sheets, wires, plastic powder and/or pallets, fiber boards, wood, metallic and non-metallic tubes, rods, special paper, etc., into the various intermediate components and parts into such completed and finished articles: Provided, however, That if the following parts are intermediate components of a finished article, except as used in the tuner assembly, they must be locally manufactured within the manufacturing enterprise or any other local manufacturing enterprise:

1. Printed circuit boards;
2. Transformers;
3. Coils, except yoke and flyback, and sheet metalware attached hereto except the mask;
4. Cabinets; and
5. Chassis.

(As amended by Rep. Act No. 6110)

Sec. 186. Percentage tax on sales of other articles.- There shall be levied, assessed and collected once only on every original sale, barter, exchange and similar transaction either for nominal or valuable considerations, intended to transfer ownership of, or title to, the articles not enumerated in sections one hundred and eighty-four, one hundred and eighty-five, one hundred and eighty-five-A, and one hundred and eighty-five-B a tax equivalent to seven per centum of the gross selling price or gross value in money of the articles so sold, bartered, exchanged, or transferred, such tax to be paid by the manufacturer, or producer: Provided, That where the articles subject to tax under this section are manufactured out of materials likewise subject to tax under this section and section one hundred and eighty-nine, the total of such materials, as duly established, shall be deductible from thegross selling price or gross value in money of such manufactured articles. (As amended by Rep. Act No. 6110)

Sec. 183. Payment of percentage taxes.- (a) In general.- Unless otherwise specifically provided, it shall be the duty of every person conducting a business on which a percentage tax is imposed under this Title, to make a true and complete return of the amount of his, her or its gross quarterly sales, receipts, or earnings or gross value of output actually removed from the factory or mill warehouse and within twenty days after the end of each quarter pay the tax due thereon: Provided, That any person retiring from a business subject to the percentage tax shall notify the nearest internal revenue officer thereof, file his return or declaration, and pay the tax due thereon within twenty days after closing his business.

For purposes of this section, sales on consignment shall be considered actually sold on the day of sale or sixty days after the date consigned, whichever is earlier.

If the percentage tax in any business is not paid within the time specified above, the amount of the tax shall be increased by twenty-five per centum the increment to be a part of the tax and the entire unpaid amount shall be subject to interest at the rate of fourteen per cent per annum.

In case of willful neglect to file the return within the period prescribed herein, or in case a false or fraudulent return is willfully made, there shall be added to the tax or to the deficiency tax in case any payment has been made on the basis of such return before the discovery of the falsity or fraud, a surcharge of fifty per centum of its amount and the entire unpaid amount shall be subject to interest at the rate of fourteen per centum per annum. The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the falsity or fraud, in which case, the amount so added shall be collected in the same manner as the tax."

Anent the first issue, petitioner contends that the blank cassette tapes are subject to only 7% as ordinary articles and not to Sections 185(d), 185-B(g) at 40% because these blank cassette tapes are not articles which reproduces or records music and sound.

On the other hand, respondent contends otherwise asserting that cassette tapes are like "phonograph records" which are subject to tax at 40% of the gross selling price thereof.

We agree with the contention of petitioner that the blank cassette tapes it manufactured and sold are subject only to 7% tax as ordinary article and not to 40% tax under Sections 185(d), 185(g) and 185-B(g) of the Old Tax Code. As can be gathered from the evolutionary development of Section 185 of the Tax Code, beginning from June 1, 1939 thru 1971, it shows that generally what was subject to sales tax are those articles, among which justly was musical instrument, which records and reproduces music, specifically including "phonograph records".(CA 466, RA 217, June 1, 1948, RA 396, June 18, 1949; RA 588, Sept. 22, 1950, RA 1612, Aug. 24, 1956.) In the last cited law, RA 1612, it provided that what are taxed are those enumerated therein, and those "similar articles for reproducing music". Section 185-B(g) of the Tax Code, confirms the evolution of the provision of Section 185, which taxed "(g) similar articles for reproducing and/or recording music and sound, like tape recorders, etc." and that this confirms the statutory construction rule of ejusdem generis to the effect what are taxed are those articles that records and/or reproduces music, specifically like in the case of phonograph records, tape recorders, etc. Sections 185(d), (g) and 185-B(g) of the Old Tax Code, upon which respondent based his decision dated April 18, 1983 and on the basis of which imposed the 40% sales tax on the petitioner's cassette tapes manufactured and sold do not apply on blank magnetic cassette tapes to which we fully agree with petitioner. And to borrow the words of counsel for petitioner, which we find to be creditably presented, as it is based on the true facts and the law of the case, he said and we quote:

> "xxx Sec. 185(d) covered 'articles of which celluloid is the component material of chief value' and the undisputed evidence is that the cassette tape is made of plastic case and cover and polyester tape and does not contain any celluloid. Sec. 185(g) also did not apply because it covered only 'pianos; phonograph records (except thoselocally manufactured and those used for educational purposes); jukeboxes.' Respondent states that 'cassette tapes are like phonograph records' taxed at 40% but his statement is correct as regards imported phonograph records; locally manufactured phonograph records were not included in Sec. 185(g) and not taxed at 40%. So even assuming the cassette tapes and phonograph records are the same in the sense that they are articles in which sound or music can be recorded or stored, petitioner's

> cassette tapes should not be taxed at 40% because they were locally manufactured. Finally, Sec. 185-B(g) also did not apply because the cassette tapes were not 'similar articles for reproducing and/or recording music and sound' as discussed and explained in the preceding discussion on the legislative history of Sec. 185. By the process of elimination, therefore, cassette tapes fall under Sec. 186 because they were not enumerated in Secs. 184, 185, 185-A and 185-B so that the applicable sales tax rate is 7%. (pp. 84-85, CTA rec.)

We would like to add to petitioner's aforesaid observation and conclusion that the blank magnetic cassette tapes of petitioner, which are imported in master rolls from the United States, is not made of celluloid but of tensilized polyester as confirmed by the National Institute of Science and Technology. And these blank magnetic cassette tapes are unlike phonograph records because the latter is something where sound have been recorded; or is a disc with a spiral groove carrying recorded sound or phonographic reproduction (Webster's New Collegiate Dictinary, 1977 Ed., p. 862l; underlining supplied), while in the case of the blank magnetic cassette tapes of petitioner in question, there are still no sound recorded therein or phonographic reproduction that can come therefrom. Clearly, without sound or music recorded on the blank cassette tapes of petitioner, these cannot be like phonograph records and taxed under Sections 185(d), (b), or 185-B(g), since it is not one of those articles enumerated under 185-B(a) to (f), or are similar articles thereto, all of which records or reproduces sound or music. Consequently, we are of the opinion that the blank cassette tapes manufactured and sold by petitioner in this case is only subject to or liable for 7% sales tax as ordinary articles under Section 186 of the Old Tax Code. The imposition of 40% sales tax by respondent in his assessment against petitioner upon its blank cassette tapes in the sum of ₱216,790.37 is hereby declared illegal and void, and is, therefore, set aside.

Coming now to the second issue, petitioner contends that it is not liable to the deficiency contractor's tax in the amount of ₱9,359.40. It argues that it has paid its fixed contractor's tax on the annual basis in 1975. On the other hand, respondent maintain the opposite view.

We are in conformity with the position taken by petitioner. Petitioner had paid a total of ₱14,499.86 as contractor's tax for 1975, computed as follows:

Total Amount Paid - 1975 (BIR Schedule I)	₱10,976.71
Less: Total Amount Paid (Nov. & Dec. 1975)	421.50
Sub Total	₱10,555.21
Add: Total Amount Paid (Nov.-Dec. 1974)	3,944.65
Adjusted Total Amount Paid FY 10-31-75	₱14,499.86

(p. 86, CTA rec.)

Upon a total 1975 gross receipts of ₱365,889.33, itemized as follows:

Gross receipts for July-Dec. 31, 1975	₱285,597.33
1975 percentage tax returns (Exhs. D to G)	107,292.00
Total Gross receipts for FY ended Oct. 31, 1975	₱365,889.33

petitioner had undisputedly paid a total contractor's tax of ₱14,499.86 aforesaid. The payment of all business taxes of petitioner for fiscal year ended October 31, 1975 had been confirmed by the respondent's examiners (Antonio C. Atienza and Eleuterio S. Rabe), who reported that, with respect to petitioner's alleged tax obligations, "x x x Further, verification also disclosed that all returnable income, or those which could otherwise be subject to business/percentage taxes, were found to have been correctly returned in the books of accounts and reflected in the corresponding tax returns".

Consequently, and in sum, we are of the opinion and so hold that petitioner is not liable for the deficiency sales and contractor's tax assessed against it by respondent for the calendar year 1975.

WHEREFORE, the decision of respondent Commissioner of Internal Revenue assessing against petitioner the total sum of ₱226,145.78 as deficiency sales and contractor's taxes for the period November 1, 1974 to October 31, 1975 should be, as it is hereby, reversed.

No pronouncement as to costs.

SO ORDERED.

Quezon City, Metro Manila, August 18, 1987.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

ALEX Z. REYES
Associate Judge