REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

March 29, 1957

COSMOS KAPOK FACTORY,
Petitioner,

- versus - C.T.A. CASE NO. 125

J. ANTONIO ARANETA, Collector
of Internal Revenue,
Respondent.

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D E C I S I O N

Petitioner Cosmos Kapok Factory prays for the review of the assessment made by respondent Collector of Internal Revenue demanding from the former the sum of ₱1,557.90 as sales tax on its sales of processed kapok from May 20, 1954 to September 20, 1954 including surcharge and penalty.

The case was submitted principally on the basis of the Bureau of Internal Revenue records (hereinafter cited as "BIR rec.", for brevity) and on joint Exhibits 1 and 2.

There is no dispute that petitioner purchased husked raw kapok which are then made to undergo, with the use of machineries, a process which is described as follows:

> "x x x The raw kapok goes first to the upper horizontal chamber where it is beaten up by big steel blades or paddles attached to a revolving shaft with the fiber material remaining on top while the seed and cores or heavier materials drop to the lower section by specific gravity. The lighter fiber moves along to the lower horizontal

> chamber equipped with small steel blades or paddles also attached to a revolving shaft where it is still beaten up to drive away the foreign materials to the bottom by loosening up the fiber to make it lighter and is thus drawn to the blower which provides a suction force or produces a current without, of course, the heavier fibers or cores to the opening and thence blow it away to the receiving room. The product turned out is, therefore, cleaned kapok. The cores are fed to a vertical chamber to produce cleaned kapok of lesser quality used by the factory in the manufacture of mattresses." (p. 50, BIR rec.)

The kapok which comes out of the above described process is clean, without seeds and cores. Petitioner sells the clean kapok to consumers or to other factories or utilizes the said processed kapok in the manufacture of mattresses and/or pillows likewise sold to the public.

On May 20, 1954, the Collector of Internal Revenue sent a letter (p. 4, BIR rec.) assessing against and demanding from the petitioner Cosmos Kapok Factory, the amount of ₱10,988.74 as sales tax on its total sales from 1951 to 1953, together with surcharge and compromise penalty on the theory that the petitioner is liable for manufacturer's 7% tax prescribed by section 186 of the National Internal Revenue Code and for non-payment therefor violated the provisions of section 183 in relation to section 209 of the Tax Code. After an exchange of communication between the parties, the Collector of Internal Revenue on February 15, 1955 issued a revised assessment (Exhibit "B", p. 37, BIR rec.), reducing the amount demanded to ₱1,557.90 as sales tax on petitioner's sales of processed kapok from May 20, 1954 to September 20, 1954 plus surcharge and compromise penalty detailed as follows:

Gross sales from 5/20 to 9/30/54 ..... ₱16,661.65	
7% tax due on ₱16,661.65	₱1,166.32
25% surcharge thereon	291.58
Penalty	100.00
TOTAL AMOUNT DUE & COLLECTIBLE.	₱1,557.90

On March 9, 1955, the petitioner wrote respondent, requesting for a reconsideration of the assessment on the ground that it was not a manufacturer and further asked to be given the opportunity to present its side of the case before being compelled to pay the tax assessed (Exhibit "C", "C-1", pp. 38, 39, BIR rec.). However, respondent denied this request in a letter dated March 31, 1955 (Exhibit A, p. 40, BIR records) and reiterated his demand for payment of the assessment. Hence, petitioner interposed the instant petition for review, which was filed on May 5, 1955. Respondent, in his answer, interposed as affirmative defense that this Court has no jurisdiction over the petition for review.

The issues involved in this case are as follows: (1) Whether the court has jurisdiction to entertain the present petition for review; and (2) Whether petitioner is a manufacturer in contemplation of section 194 (x) of the National Internal Revenue Code.

Relative to the question of jurisdiction, we believe that the present petition for review was filed within the reglementary period of thirty (30) days provided for by law. The record of the case shows that the revised assessment in question is dated February 15, 1955 but there is no evidence as to how and when this assessment was served upon petitioner. Giving all the benefit of the doubt in favor of the petitioner we may presume that the assessment was received, at the latest on March 9, 1955, the date of petitioner's letter for reconsideration of even date (Exhibit C) was filed with respondent, without having consumed any portion of the thirty-day period within which to appeal. The denial thereof was made by respondent in a letter dated March 31, 1955 which letter, according to testimonial evidence presented by petitioner (Hearing of October 3, 1955) was received on April 11 or 12, 1955. Therefore, counting the period from the earlier date April 11, 1955, when denial of the request for reconsideration was received to May 5, 1955, the date of the filing of the present petition for review, petitioner consumed only twenty four (24) days, which is well within the reglementary period prescribed by section 11, Republic Act No. 1125 and this Court can take cognizance of this case.

We shall now proceed to consider the main question. The assessment herein is based on sections 183 (A) and 186 in relation to section 194 (x) of the Tax Code. The respondent maintains that petitioner is a manufacturer as defined in section

194 (x) of the National Internal Revenue Code and its sale of the processed kapok is subject to the 7% tax prescribed in section 186 thereof. On the other hand, petitioner denies that it is a manufacturer and therefore, argues that the sales tax may not be imposed upon its business.

Section 194 (x) of the Tax Code, over which the issue hinges, states:

> "(x) 'Manufacturer' includes every person who by physical or chemical process alters the exterior texture or form or inner substance of any raw material or manufactured or partially manufactured product in such manner as to prepare it for a special use or uses to which it could not have been put in its original condition, or who by any such process alters the quality of any such 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, or who by any such process combines any such raw material or manufactured or partially manufactured products with other materials or products of the same or of different kinds and in such manner that the finished product of such process of manufacture can be put to a special use or uses to which such raw material or manufactured or partially manufactured products in their original condition could not have been put, and who in addition altess such raw material or manufactured or partially manufactured products, or combines the same to produce such finished products for the purpose of their sale or distribution to others and not for his own use or consumption."

Analyzing the foregoing provision, this Court has ruled:

> "For an analysis of the provisions of section 194 (x), supra, will readily show that the definition of manufacturer is so broad and comprehensive that the mere altering of the exterior texture, form or

inner substance of any raw material, manufactured or partially manufactured product, by physical or chemical process, in such manner as to prepare it for a special use or uses to which it could not have been put in its original condition, constitutes manufacturing. Likewise, the alteration of the quality of such raw material, manufactured or partially manufactured product, by the same process, as to reduce it to marketable shape or prepare it for any of the uses of industry, is a manufacturing process. Even the combining of these things with other materials or products, by physical or chemical process, in such manner that the finished product may be put to a special use to which such raw material, manufactured or partially manufactured products could not have been destined, makes one a manufacturer. While it is necessary that the purpose is for sale or distributed to others, it seems that the finished product need not be transformed into a new, different, distinctive article having an entirely separate name and character. It is hardly necessary to add -

> 'The term manufactured article or product includes anything which is changed by process of manufacture from its natural form such as iron ore to iron, logs, to lumber or timber, bones to bone dust, potatoes to potato chips, corn to corn meal, and water to ice.' (Attorney General vs. Lorman, 26 NE 32).

(Philippine Packing Corporation vs. Collector of Internal Revenue, B.T.A. No. 182, January 31, 1955, reversed on other grounds; see also American Rubber Company v. Collector C.T.A. No. 111, June 14, 1956). (Underscoring supplied.)

We are of the opinion that petitioner falls squarely under the second classification mentioned in section 194 (x) of the Tax Code, viz: "any one who by any such (physical or chemical) process alters the quality of any such 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;" This observation is corroborated by a report of the process as ascertained by Mr. Conrado Letho, a technologist of the Institute of Science and Technology and included in a report of Mr. Rodolfo Serraon, a revenue agent, from which we quote:

> "(4) Changes effected on the finished product as compared with the raw material.- The raw material is the thick, tough, and sticky fiber with the seeds and cores. The finished product is the light fiber (loosened up by machinery) with seeds and cores. The principal change effect on the finished product is, therefore, the looseness of the fiber cleaned of all sediments or foreign materials (seeds, cores, and dirt). The cleaned kapok thus assumes a different form or exterior texture fit for special use in the stuffing of pillows and cushions as distinguished from the raw kapok which, without the seeds but not necessarily the cores, may be used without much processing to stuff heavier or less delicate articles like mattresses and seats. It should be borned in mind also that the factory turned out two classes of cleaned kapok - the higher quality kapok being sold as a finished product in itself and the lesser quality kapok, which is derived from cores, being utilized by the factory in its manufacture of mattresses. Undoubtedly, the quality of looseness is the main feature of the cleaned kapok which distinguished it as a manufactured product from the raw kapok considered as an agricultural product. (p. 49, BIR records).

The above described process clearly indicate that the kapok is sufficiently changed by means of machinery, such that a thick and tough raw kapok is transformed into a cleaned and light kapok, thereby altering its quality so as to reduce it to marketable shape or prepare it for any of the uses of industry and thus become a distinct class of merchandise (see

Ngo Siek vs. Collector, 52 O.G. No. 16, p. 6873). We are therefore of the opinion and so hold that petitioner is a manufacturer as defined in section 194 (x) of the National Internal Revenue Code and as such liable for the 7% tax on its sale of processed kapok prescribed by section 186 thereof.

However, with regards to the compromise penalty of ₱100.00 sought to be collected from petitioner, in extrajudicial settlement of the penalty prescribed in section 209 of the Tax Code, we believe that this Court has no jurisdiction to compel petitioner to pay the same. We have consistently held that a compromise penalty by its very nature implies a mutual agreement by both parties in regard to the thing or subject matter which is to be compromised. (Briñas vs. Collector, C.T.A. No. 16, Sept. 14, 1955; Central Azucarera de Tarlac vs. Collector, C.T.A. No. 90, July 9, 1956) and the choice of paying or not paying it distinctly belongs to petitioner.

WHEREFORE, the decision of the Collector of Internal Revenue is hereby modified in the sense that petitioner is hereby ordered to pay the sum of ₱1,457.90 as sales tax on its sales of processed kapok from May 20 to September 30, 1954 including surcharge. With respect to the sum of ₱100.00 demanded as compromise penalty, petitioner is at liberty to refuse to pay the same, without prejudice to the right of respondent to institute proceedings for the

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enforcement thereof, as the facts and circumstances may warrant. With costs against petitioner.

SO ORDERED.

Manila, Philippines, March 29, 1957.

MARIANO NABLE
Presiding Judge

WE CONCUR:

AUGUSTO M. LUCIANO
Associate Judge

ROMAN M. UMALI
Associate Judge