REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

CONTINENTAL MANUFACTURING CORPORATION,
Petitioner,

versus

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Dec. 27, 1968

CTA CASES NOS. 1027, 1324 & 1351

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D E C I S I O N

C. T. A. Case No. 1027 is an appeal from the decision of respondent demanding from petitioner the payment of: deficiency sales tax plus surcharge and compromise penalty for the years 1956-1959 in the total sum of ₱174,721.94; deficiency income tax and interests for the years 1956, 1958 and 1959 in the aggregate amount of ₱9,694.79; and additional residence tax and surcharge for 1956 in the amount of ₱6.25. C. T. A. Cases Nos. 1324 and 1351 are both claims for refund in the respective amounts of ₱614.92 and ₱27,226.94, as alleged overpayments of sales and residence taxes for the years 1960 to 1962. These three cases were consolidated because they involve a common issue.

It appears in CTA Case No. 1027 that petitioner, a duly organized domestic corporation, has been engaged in the manufacture of sewing threads since 1952. On November 9, 1953 petitioner was granted tax exemption, effective June 20, 1953, for the manufacture of cotton, rayon, ramie and abaca sewing threads under Republic Act No. 901 which entitled petitioner to exemption from the payment of taxes directly payable by it in respect to the said industry. On November 11, 1959 petitioner filed a supplementary application for exemption for the manufacture of crochet threads, embroidery threads and rug yarns (Exh. A-4, Petitioner's Envelope of exhibits; Exh. 26-A, pp. 25-37, Vol. II, BIR rec., CTA 1027) and on December 8, 1959, petitioner was granted tax exemption for the manufacture of crochet threads and rug yarns only. The exemption was made effective November 12, 1959, the date the application was filed with the Department of Finance (Exh. A-3, Petitioner's Envelope of exhibits; Exh. 15, pp. 127-128, Vol. I, BIR rec., CTA 1027).

In an investigation conducted by agents of the Department of Finance and respondent's examiners, the latter found that petitioner manufactured crochet threads since August 24, 1956 using tax exempt machinery, equipment and materials in violation of the tax exemption law and regulations. As a result of the finding, the Secretary of Finance, on December 1, 1960, suspended effective August 24, 1956 the privilege for the manufacture of cotton, rayon, ramie and abaca sewing thread on the ground that petitioner manufactured taxable articles, in the manufacture of which tax-exempt machineries, equipment and raw materials were used in violation of the tax exemption law and regulations (Exh. 2, pp. 53-54, Vol. II, BIR rec., CTA 1027). Several requests for reconsideration and lifting of the order of suspension were made by petitioner on the ground that crochet thread was within the exemption grant for sewing threads. The requests were all denied by the Secretary of Finance. (See Exhs. R, S, T, U, V, W and X, Petitioner's Envelope of exhibits.)

In a letter dated December 8, 1960, respondent assessed against and demanded from petitioner the payment of deficiency income tax and interests for the years 1956, 1958 and 1959 in the total sum of ₱9,694.79 and additional residence tax and surcharge for 1956 in the sum of ₱6.25 (Exh. E, pp. 11-12, CTA rec.; Exhibit 25, pp. 207-208, Vol. I, BIR rec., CTA 1027). In another letter dated December 13, 1960, respondent also assessed against and demanded from petitioner the payment of deficiency sales taxes, surcharge and compromise penalty for the years 1956 to 1959 in the total sum of ₱174,721.94 (Exh. F, p. 13, CTA rec.; Exh. 26, pp. 209-210, Vol. I, BIR rec., CTA 1027). These assessments were made on the theory that the exemption in question became inoperative since August 24, 1956 upon its suspension by the Secretary of Finance as adverted to above. On January 9, 1961, petitioner requested a reconsideration of the aforesaid assessments, stating among others that crochet thread constitutes a specie under sewing thread and, therefore, is within the exemption (Exh. G, p. 14, CTA rec.; pp. 214-215, Vol. I, BIR rec., CTA 1027). However, respondent denied said request for reconsideration (Exh. H, p. 15, CTA rec.; p. 216, Vol. I, BIR rec., CTA 1027).

In CTA Case No. 1324, it appears that pending the request to lift the suspension of petitioner's tax exemption privilege, which was never made, and during the period between January 1, 1961 and March 20, 1962, petitioner paid under protest the full tax under protest upon the insistence of respondent. Petitioner now claims to be entitled to the exemption and insists that it should pay the diminishing rate provided in the law and the grant and not the full tax. The sum of ₱614.92 represents the refundable sum if petitioner's theory prevails.

In CTA Case No. 1351, petitioner asks for the refund of the amount of ₱27,841.86 under the same theory as in CTA Case No. 1324, for allegedly overpaid sales and residence taxes for the period from February, 1961 to February, 1962 inclusive.

Petitioner admits that it used tax exempt machinery, equipment and material for the manufacture of crochet thread as found by the Secretary of Finance but it urges that crochet thread is included in the tax exemption grant of November 9, 1953 for the manufacture of cotton, rayon, ramie and abaca sewing threads. It is alleged that crochet thread can be used for sewing bags and hence it is also sewing thread. We cannot accept this theory.

According to Benedicto Dacanay, petitioner's own witness, in the commercial and manufacturing world sewing threads and crochet threads are distinct products; they are of different construction and they undergo different manufacturing processes. Needless to say, to the general public crochet thread and sewing thread are also different products. In the absence of a definitely indicated intention that words and phrases should be construed otherwise, we must apply them according to their usual acceptation.

They should not be

given an expansive meaning specially in grants of tax exemption in the light of the accepted rule that tax exemption should be strictly interpreted. (Comm. of Int. Rev. v. Guerrero, et al., G. R. No. L-20942, September 22, 1967.)

It is significant that petitioner, in its original application for the manufacture of cotton, rayon, ramie and abaca sewing threads attached thereto a flowsheet (Exh. 1-A, pp. 1-3, BIR rec., Vol. II, CTA Case No. 1027). Diagram 3-A of the said flowsheet represents a slub catcher and tensioning device with the following inscription:

> Yarn is run through slub catcher and tensioning device to remove excess lint and tension yarn for close winding of cops or tubes. Yarn also passes between wax discs to make <u>yarn smooth for passing through eye of sewing machine needle</u> and fabric. (Underlining ours.)

Diagram 4 of the same flowsheet shows an ordinary sewing machine with the following inscription:

> Finished thread is tested on sewing machine for running efficiency.

With this flowsheet petitioner clearly manifested its intention to manufacture only ordinary sewing thread which is smooth and devoid of excess lint and tension in order that it can pass through the eye of sewing machine needle and fabric. Crochet thread cannot pass this test.

Again, in an application dated November 11, 1959, petitioner asked for tax exemption for crochet thread, embroidery thread and rug yarn, distinctly classifying each as a separate item. Acting upon this application, the Secretary of Finance granted exemption "in respect to the manufacture of crochet thread and rug yarns only." This is a clear manifestation that in the grant of tax exemption in question, the grantor as well as the grantee, follows the classification of threads in the commercial and manufacturing world and their usual acceptation.

(Petitioner's claim of good faith in the manufacture of crochet thread is beside the point. Whether it acted in bad faith or good faith petitioner is still liable for the taxes involved herein. The same holds true with regard to the surcharges and penalties as long as the government has not misled it, which is not claimed in this case.)

Petitioner lastly contends that the suspension of the tax exemption as of the violation of the conditions imposed in the grant was not valid because Republic Act No. 901 does not expressly authorize such a retroactive suspension. We can not subscribe to this thesis.

Section 8 of the aforesaid law provides as follows:

> SEC. 8. The Secretary of Finance may suspend the privilege of tax exemption if the grantee fails to comply with any of the obligations imposed by this Act.

The foregoing provision obviously stipulates a conditional tax exemption. The grant is subject to suspension upon violation of its terms, the right to suspend accruing at the very instant of the violation. This right is distinct from the order of suspension which is but its enforcement. Needless to say, if the violation is discovered immediately the right of the Secretary of Finance to forthwith suspend the grant can hardly be contested. We cannot see why the Secretary of Finance cannot suspend the grant effective as of the start of the violation just because discovery was made sometime later.

With respect to the compromise penalty of ₱10,000.00, it is well settled that it cannot be imposed and collected without the consent of the taxpayer (Coll. of Int. Rev. v. UST & The CTA, G.R. Nos. L-11274 & L-11280, Nov. 28, 1958).

WHEREFORE, the petitions in CTA Cases Nos. 1324 & 1351 are hereby dismissed. The decision in CTA Case No. 1027 is hereby modified and petitioner is hereby ordered to pay respondent the sum of ₱164,721.94 as deficiency sales tax and 25% surcharge for the years 1956-1959; to pay respondent ₱9,694.79 as deficiency income tax, with the delinquency penalties provided in Section 51(e) of the Revenue Code, and to pay respondent ₱6.25 as additional residence tax and surcharge for 1956. With costs against petitioner.

SO ORDERED.

Quezon City, December 27, 1968.

RAMON L. AVANCEÑA
Associate Judge

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

ESTANISLAO R. ALVAREZ
Associate Judge