REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MIGHTY CORPORATION,
Petitioner,

- versus - **C.T.A. CASE NO. 4517**

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUN 24 1998

x - x

D E C I S I O N

This is a petition for review seeking to set aside the decision of the respondent Commissioner of Internal Revenue subjecting herein petitioner to pay the amount of Six Hundred Ninety Eight Thousand Three Hundred Ninety Three Pesos and 25/100 (₱698,393.25) representing alleged deficiency excise tax for its purchase and importation of stemmed-leaf tobacco, covering the period January 1, 1986 to June 30, 1989.

Petitioner Mighty Corporation is a corporation engaged in the production and manufacture of cigar and cigarettes, which it makes out of stemmed-leaf tobacco. It purchases the stemmed leaf tobacco in bulk from both local and foreign tobacco manufacturers.

On January 4, 1990, petitioner received a letter

258

from the BIR, dated December 18, 1989, demanding the payment of ₱548,151.00 "as deficiency excise tax on your importation and local purchase of stemmed leaf tobacco covering the period from January 1, 1986 to June 30, 1989, exclusive of surcharges and interest, within ten (10) days from receipt hereof."

The BIR letter demanding the payment of alleged deficiency excise tax was essentially based on Section 141(b) of the National Internal Revenue Code (NIRC), to wit:

> "**Section 141.** - There shall be collected a tax of ₱0.75 on each kilogram of the following products of tobacco:
>
> xxx xxx xxx
>
> (b) Tobacco prepared or partially prepared with or without the use of any machine or instrument or without being pressed or sweetened; and
>
> xxx xxx xxx
>
> 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 pre-payment of the specific tax herein provided for under such conditions as may be prescribed in the 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.

Petitioner, in its letter to the Commissioner dated January 12, 1990, protested the demand for payment of P548,151.00 and requested for the reconsideration and withdrawal of the assessment in question on the ground that the BIR assessment was based solely on Section 141(b) of the NIRC without, however, applying Section 137 thereof, the more specific provision, which expressly allows the sale of stemmed leaf tobacco as raw material by one manufacturer directly to another without payment of the (excise) tax. Moreover, petitioner made reference to a BIR ruling, dated December 12, 1972, wherein BIR expressly ruled that under Sec. 137 of the NIRC, the sale of partially manufactured tobacco from a wholesale leaf tobacco dealer (L-3R) to a manufacturer of tobacco products (L-7 *1/2*) "for use in the manufacture of cigar and cigarettes may also be allowed without prepayment of the tax."

The BIR, in its letter, dated August 31, 1990, and received by petitioner's counsel on November 26, 1990, denied the protest, the dispositive portion is quoted as follows:

> "Clearly, from the aforequoted ruling, the

2lct

transfer or sale of partially manufactured tobacco, as a rule, is subject to specific tax unless there is an express grant of exemption from the payment of tax. The taxpayers up to this point in time have not presented any authority issued by the BIR granting them exemption."

On October 17, 1990, the BIR reiterated its demand for the payment of the alleged deficiency excise taxes, then increased to P698,393.25, computed as follows:

Prior years 1986-87:		***No. of Kilos***
L-6-14	Tobacco Ind. of the Phil.	437,000
6-183	Fieldman Tobacco Corp.	161,148
6-4	P.T.F.C.	61,520
L-7-1004	La Reyna Chewing Tob. Corp.	71,200
Per stocktaking:		
L-6-002	N.G.C. Trading	19,783
6-183	Fieldman Tobacco Corp.	15,750
6-4	P.T.F.C.	40,900
7-1004	La Reyna Chewing Tob. Corp.	123,191
		x .75/K
		698,393.25
		==========

Hence, this petition was filed on December 6, 1990.

The sole issue to be resolved is whether or not petitioner is liable for the payment of P698,393.25 representing the deficiency excise tax assessment covering the period beginning January 1, 1986 to June 30, 1989.

Petitioner, in claiming that it is not liable for

261

the payments of excise tax for its importation and local purchase of stemmed leaf tobacco, relied heavily on Section 137 of the NIRC, which in part reads as follows:

> "**Section 137.-** *x x x* 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 regulations of the Department of Finance. (*Underscoring supplied*)

Respondent, on her part, argued that the liability of petitioner to pay the deficiency excise tax is governed by Section 141 of the NIRC, hereinbefore quoted. Likewise, respondent averred that under Revenue Regulations No. 17-67, particularly Section 1, par. 1, a stemmed leaf tobacco has been considered a partially prepared tobacco within the ambit of Section 141 of the NIRC.

In the light of the decision of the Court of Appeals in the case entitled Commissioner of Internal Revenue vs. ***Fortune Tobacco Corporation, CA-G.R. Sp. Nos. 38219 and 40313 dated January 30, 1998***, we find for the petitioner. In said case, the Court of Appeals ruled:

> "There is no disputing the fact that stemmed leaf tobacco is not among the tobacco

products expressly mentioned in Section 141. The issue, therefore, is whether or not Revenue Regulations No. 17-67 is valid insofar as it interprets the statutory term "partially prepared tobacco" so as to include stemmed leaf tobacco.

It is an elementary principle of Administrative Law that in interpreting or implementing a provision of law, a government agency cannot go beyond the terms and provisions of the basic law. Much less can it go against the law itself. Administrative rules and regulations issued by a particular department or agency must be in harmony with the provision of law and should be for the sole purpose of carrying into effect the statutory provisions which it is construing or implementing. An administrative agency cannot extend, diminish, or otherwise amend the general provision of law (Fernando Juan vs. Musngi, 155 SCRA 133 [1987]; U.S. vs. Tupasi Molina, 29 Phil. 119; Director of Forestry vs. Munoz, 23 SCRA 1183 [1968]; Gonzalo Sy vs. Central Bank, 70 SCRA 570 [1976]; Bautista vs. Juinio, 127 SCRA 342 [1984]).

There are limitations to the rule making power of administrative agencies. When Congress authorizes an administrative body to promulgate rules and regulations to implement a given legislation, all that is required is that the regulation must not contravene the statute, but must conform to the standards it prescribed (Tayug Rural Bank vs. Central Bank, 146 SCRA 120 [1986]; Del Mar vs. Philippine Veterans Administration, 52 SCRA 340 [1973]).

xxx xxx xxx

In case of discrepancy between the basic law and a rule or regulation issued to implement it, the basic law prevails. The regulation cannot go beyond the provisions and terms of the basic law (Shell Philippines Inc. vs. Central Bank, 162 SCRA 628 [1988]).

After a careful study of all aspects of the law and the revenue regulation involved in this case, We come to the conclusion that the Commissioner of Internal Revenue has not engaged in mere interpretation but has gone into unauthorized modification or amendment of the law. Only Congress can do this. Section

263

2(M)(1) of Revenue Regulations No. 17-67 is, therefore, ultra vires and invalid.

Section 137 of the Tax Code, earlier cited, expressly defines "stemmed leaf tobacco" and excludes it from payment of the tax when sold in bulk as raw material by one manufacturer directly to another. While this particular section provides for removal of tobacco products without prepayment of tax, it is significant that the Tax Code defines and classifies stemmed leaf tobacco under its Section 137. When Revenue Regulations No. 17-67 undertakes to classify stemmed leaf tobacco under Section 141 in a manner different from the way it is treated in Section 137, it is no longer engaged in mere classification. It is already adding something to the law not in consonance with what the law itself specifically provides but contrary to it. It is not only engaged in amendment but in amendment contrary to a specific provision of the same law.

The petitioner argues that Section 137 is for one tax purpose while Section 141 is for another. The fact is that the reason for one provision is also present in the other and must, therefore, be treated in the same light.

Section 141 of the Tax Code specifically excludes "fine cut shorts and refuse, clippings, cuttings stems and sweepings of tobacco resulting from the handling or stripping of whole leaf tobacco" from the 75 centavos per kilogram tax when disposed of or sold. The condition in the statute is that the above must be exported or used in the manufacture of other tobacco products. The reason for the exclusion is that the excise tax will eventually be paid on the finished product.

The same reason applies to stemmed leaf tobacco which is intended solely as a raw material in the manufacture of cigarettes and other tobacco products. After the cigarettes are manufactured, excise taxes will be paid. In effect, what the petitioner has provided in the disputed regulation is double taxation - the payment of excise taxes on the raw material and later, the payment of excise taxes on the manufactured product. Double taxation must be specifically and clearly provided by law. It

264

cannot be imposed by administrative rule-making body. If specifically excluded under the last paragraph of Section 141, taxes cannot be included under paragraph 2 of the same section by a mere interpretation of the petitioner.

It is elementary that any taxes not specifically imposed by law cannot be mandated on the strength of an administrative regulation which purports to implement the said law. Only Congress, not the BIR, can provide for additional taxes. Revenue Regulations No. 17-67 is correct when it provides for the procedure in enforcing the statute. It can state the rules, taxation-wise, on securing permits, putting up factories and machineries, procuring raw materials, recording production, and disposing of the finished product. But the petitioner's powers are limited to procedure and implementation and not substantive law which seeks to add new taxes in addition to those specifically taxed under the law. This is especially true when the particular product being taxed by regulation is expressly excluded from taxes in another section of the same law and also in another law. The petitioner is arrogating powers to itself which it does not possess.

The argument that stemmed leaf tobacco used as raw material is exempt from taxation only when it is from one L-7 manufacturer to another L-7 manufacturer suffers from the same infirmity. It is based on the BIR's own Revenue Regulations V-39 which add to the law something which is not there. Using its power of classification, the petitioner has ventured into an amendment and amplification of the basic law.

Section 141 taxes fine cut shorts and refuse, scraps, clippings, stems and sweepings but the unnumbered paragraph after Section 141(c) exempts these items if they are used in the manufacture of other tobacco products on which the excise tax will eventually be paid on the finished product.

The law defines and exempts certain raw materials on condition that excise taxes will eventually be paid on the finished manufactured product. The BIR has classified these raw materials in a restrictive manner - only from one L-7 to another L-7 when all that the law requires is that the excise taxes not collected at the start will eventually be paid once the tobacco product comes out in final form. For a wide variety of raw materials, there is double imposition by the BIR of excise taxes when the law obviously removes taxes at the start of the manufacturing process and imposes them only once - when the process is completed. Again, double taxation is valid but only when it is provided by statute. It cannot be imposed through an interpretative rule.

The petitioner's contention that the classification of stemmed leaf tobacco as "partially manufactured tobacco" under Revenue Regulations No 17-67 prevails over the definition of processed tobacco under Rep. Act 698 is fanciful to say the least. Revenue Regulations No 17-67 is not a basic law. It is simply an implementation of the statutory provision of the Tax Code. A mere regulation of a quasi-legislative agency cannot prevail over the express definition under a law passed by Congress itself. It is elementary that an administrative regulation cannot amend or repeal the express provisions of statutes enacted by Congress. How can the petitioner argue that an administrative regulation prevails over a statute or law?

The petitioner states that Sections 141 and 137 of the Tax Code must be read and construed together. It explains that under Section 141 stemmed leaf tobacco, being partially prepared tobacco is subject to specific tax. However, under Section 137 if the stemmed leaf tobacco is sold in bulk directly from one manufacturer to another in accordance with the conditions prescribed in Section 20(a) of Revenue Regulation No. V-39, it is exempt from specific tax. It is very obvious that it is not the Tax Code which taxes on one hand and exempts from taxes on the other hand the tobacco involved. It is the addition of a definition of partially manufactured tobacco which clashes with the law itself and the regulatory conditions of BIR which restrict the application of the law to an extremely limited class that form the basis of BIR action. The petitioner engages in legislation and then uses its own administrative or quasi-legislative powers to add a certain class of tax which is neither expressed nor contemplated in the basic law.

Zlele

We are aware of the ruling in Commissioner of Internal Revenue vs. La Suerte Cigar and Cigarette Factory, CA-G.R. SP No. 38107 issued on December 29, 1995.

We note, however, that this Court in the case of La Suerte Cigar failed to take into account the limitations in the exercise of quasi-legislative powers by administrative agencies. True, the law in Sections 141 and 137 of the Tax Code contains the phrase "under such conditions as may be prescribed in the regulations of the Department of Finance." However, the power to prescribe regulations is not a carte blanche giving the BIR full discretionary authority to add to the law. It is not a roving commission. It is subject to established and basic principles of Administrative Law enunciated in scores of Supreme Court decisions. There is no discrepancy between the principles enunciated in this decision and in the La Suerte decision except that the latter stopped short and did not go into the powers of administrative agencies. If it had gone fully and far enough into the quasi-legislative powers of Bureau of Internal Revenue, it would have arrived at conclusions fully consonant with our findings."

Clearly then from the above-quoted decision, petitioner is legally entitled to the relief sought.

WHEREFORE, in view of all the foregoing, the instant Petition for Review is hereby **GRANTED**. **ACCORDINGLY,** the assessment involved in the instant case is hereby **CANCELLED** and **SET ASIDE**. No costs.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

267

WE CONCUR:

RAMON O. DE VEYRA
Associate Judge

AMANCIO Q. SAGA
Associate Judge

CERTIFICATION

I hereby certify that the above 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