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LA TONDEÑA, INC.,
Petitioner,

- versus - C.T.A. CASE NO. 99

COLLECTOR OF INTERNAL REVENUE,
Respondent.

Dec. 7, 1955

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DECISION

This is an appeal from a decision of the respondent Collector of Internal Revenue, dated May 8, 1954, assessing and demanding from the petitioner, La Tondeña, Inc., the amount of ₱154,663.10 as specific tax on 221,046 proof liters of alcohol plus the sum of ₱10,000.00 as compromise penalty or a total of ₱164,663.10.

It appears from the evidence presented that the petitioner La Tondeña, Inc., has been for many years a licensed manufacturer of wines and liquors bearing the trade marks of "Manila Rum", "Ginebra San Miguel" and "St. George Gin". In the manufacture of its wines and liquors, the petitioner uses as basic material rectified and distilled alcohol purchased in crude form, from various sugar centrals, principally the Central Azucarera Don Pedro in Nasugbu, Batangas, and Binalbagan-Isabela Sugar Central in Negros Occidental.

During the period from June 7, 1950 to February 27, 1954, the petitioner bought from the two centrals above-mentioned, a large quantity of crude or low test alcohol which the petitioner subjected to further rectification and distillation at its distiliery plant at 1068 Velasquez, Tondo, to meet the high standard which it has set for its liquor products. In the process of further distillation and refining during the aforesaid period, 221,046 proof liters of alcohol of the bulk bought from the two centrals, were lost thru evaporation which the petitioner claims are not subject to the specific tax being demanded by the respondent. It appears that since 1937 and up to the first week of June 1950, the petitioner was allowed by the Bureau of Internal Revenue a deduction of 5.53% for loss thru evaporation.

On May 8, 1954, the respondent Collector of Internal Revenue issued an assessment and demand requiring the petitioner to pay within thirty (30) days from receipt of the said assessment, the sum of ₱154,663.10 as deficiency specific tax on the 221,046 proof liters in question, and the amount of ₱10,000.00 as compromise penalty. The formal assessment and demand of the respondent was received by the petitioner prior to the creation of this Court, or more particularly on May 28, 1954.

On June 21, 1954, the petitioner requested, and was granted by the respondent an extension of thirty (30) days within which to answer respondent's original letter of demand for payment of the assessment in question. Later, the said time to answer respondent's letter of demand was again extended by five (5) days from August 2, 1955, also upon the request of the petitioner. Finally, on August 6,1954, the petitioner replied to the assessment and demand of the respondent, protesting and questioning the said deficiency specific tax assessment, and requesting for the reconsideration of the same.

On August 26, 1954, the respondent denied the request for reconsideration of the assessment in question and ordered the petitioner "to pay the sum of ₱164,663.10 within three (3) days from your receipt hereof" (Exhibit I-7). Respondent's letter of August 26, 1954 was received by the petitioner on August 31, 1954, and on the following day, September 1, 1954, the petitioner appealed the assessment to the Conference Staff of the Bureau of Internal Revenue.

The appeal of the petitioner to the Conference Staff was given due course and was docketed as Conference Staff Case No. 367.

On September 28, 1954, the administrative appeal was set for hearing on October 21, 1954. However, the petitioner requested for three separate postponements of the hearing of which only the first two requests were granted. With regard to the third motion for postponement of the hearing before the Conference Staff, the respondent in his letter of December 22, 1954, instead of acting on the motion, required the petitioner to comply with the requirements of Department Order No.213, dated November 2, 1954, within ten (10) days from the date of the letter by paying one-half of the total assessment against it and by filing a bond to guarantee the payment of the balance of the tax assessed.

In addition, the respondent also required the petitioner to agree in writing to the suspension of the running of the period of limitation upon assessment and collection of taxes prescribed by the National Internal Revenue Code from September 2, 1954, the date the request to appeal to the Conference Staff was received by the said staff, until the case is finally decided, and for sixty (60) days thereafter. The compliance of these requirements just mentioned was made as a condition precedent by the respondent Collector of Internal Revenue to the re-setting of the case for hearing before the Conference Staff of the Bureau of Internal Revenue.

On January 10, 1955, the petitioner informed the respondent that it was agreeable to the suspension of the running of the period of limitation upon the assessment and collection of the specific tax in question. However, the petitioner requested for the reconsideration of the order with respect to the cash payment of one-half of the alleged total deficiency specific tax assessment and the filing of a bond to guarantee the payment of the balance of the tax assessed, as required by Department Order No. 213.

On February 8,1955, the respondent denied the request for reconsideration of the enforcement in full of the conditions set forth in Department Order

No. 213. Another request for reconsideration was filed by the petitioner but was likewise denied in a letter dated March 10, 1955, with the admonition that the petitioner should comply in full with said conditions within five (5) days from receipt of said notice of denial of the request for reconsideration if it so desires to be heard before the Conference Staff of the Bureau of Internal Revenue. This reply from the respondent denying the last petition for reconsideration was received by the petitioner on March 16, 1955.

Two days later, the petitioner filed its "Petition for Review" with this Court, and the case is now before us for decision by way of an appeal pursuant to sections 7 and 11 of Republic Act No. 1125.

The appeal narrows down to the following issues:

1. Has the petitioner complied with the provision of section 11 of Republic Act No. 1125, which limits the right of appeal to this Court to thirty (30) days from receipt of the decision of the Collector of Internal Revenue, so as to confer upon this Court jurisdiction to entertain its appeal?

2. Is there any legal basis to require petitioner La Tondeña, Inc. to pay the specific tax demanded by the respondent in the amount of ₱164,663.10 inclusive of penalty, on the 221,046 proof liters of crude or low test alcohol which were lost thru evaporation in the process of further rectification and distillation by the petitioner so as to meet the high standard set by it for its liquor products?

On the question of jurisdiction which was raised by the respondent as an affirmative defense in his answer to the petition for review, we note that the petitioner herein duly perfected its administrative appeal from the decision of the respondent to the Conference Staff of the Bureau of Internal Revenue, and the same was docketed as C.S. Case No. 367. While the case was pending before the Conference Staff, the respondent Collector of Internal Revenue required the petitioner "to comply with the provisions of said Department Order (No. 213, dated November 2, 1934) within five (5) days from your receipt thereof, in order that the Conference Staff may be directed to hear your case on the merits". (Exhibit I-16) This request of the respondent was contained in his letter of March 10, 1955 which was received by the petitioner on March 16, 1955.

On March 18, 1955, the petitioner, not being agreeable to the order to comply in full with the requirements of Department Order No. 213, filed its petition for review with this Court of the decision in question. From these undisputed facts, it seems quite clear and obvious that the petition for review was filed on time inasmuch as the same was filed within the five-day period fixed and granted by respondent Collector of Internal Revenue, and therefore this Court has jurisdiction to hear and determine the present appeal.

Let us now come to the principal question at issue. Is there any legal ground for requiring the petitioner to pay the specific tax on the crude or low test alcohol which was lost thru evaporation in the process of further rectification and distillation so as to meet the high standard set by the petitioner for its liquor products?

This question calls for an interpretation of section 133 of the National Internal Revenue Code under which the alleged deficiency specific tax was assessed and demanded by the respondent. Prior to January 1, 1951, the said section read as follows:

> "SEC. 133. Specific tax on distilled spirits. On distilled spirits there shall be collected, except as hereinafter provided, specific taxes as follows:
>
> (a) If produced from sap of the nipa, coconut, cassava, camote, or buri palm, or from the juice, syrup, or sugar of the cane, per proof liter, sixty centavos.
>
> (b) If produced from any other materials, per proof liter, seven pesos.
>
> "This tax shall be proportionally increased for any strength of the spirits taxed over proof spirits.
>
> "'Distilled spirits', as here used, include all substances known as ethyl alcohol, hydrated oxide of ethyl, or spirits of wines, which are commonly produced by the fermentation and subsequent distillation of grain, starch, molasses, or sugar, or of some syrup or sap, including all dilutions or mixtures; and the tax shall attach to this substance as soon as it is in existence as such, whether it be subsequently separated as pure or impure spirits, or be immediately or at any subsequent time transformed into any other substances either in process of original production or by any subsequent process.
>
> "'Proof spirits' is liquor containing one-half of its value of alcohol of a specific gravity of seven thousand nine hundred and thirty-nine ten-thousandths at fifteen degrees centigrade. A proof liter means a liter of proof spirits." (As amended by section 1, Republic Act No. 589; underscoring supplied).

However, on January 1, 1951, Republic Act No. 592 took effect amending section 133 of the Tax Code by increasing the rate of specific taxes on distilled spirits and limiting the scope and meaning of the words "distilled spirits". The all-inclusive clause "and the tax shall attach to this substance as soon as it is in existence as such, whether it be subsequently separated as pure or impure spirits, or be immediately or at any subsequent time transformed into any other substances either in process of original production or by any subsequent process" was eliminated from section 133 of the Tax Code, so that said section 133 as amended by Republic Act No. 592 now reads as follows:

> "SEC. 133. Specific tax on distilled spirits. On distilled spirits there shall be collected subject to the provisions of section one hundred and twenty-eight of this Act, except as hereinafter provided, specific taxes as follows:
>
> (a) If produced from sap of the nipa, coconut, cassava, camote, or buri palm, or from the juice, syrup, or sugar of the canep per proof liter, seventy centavos
>
> (b) If produced from any other materials, per proof liter, ten pesos.
>
> "This tax shall be proportionally increased for any strength of the spirits taxed over proof spirits.
>
> "'Distilled spirits' as here used, include all substances known as ethyl alcohol, hydrated oxide of ethyl, or spirit of wines, which are commonly produced by the fermentation and subsequent distillation of grain, starch, molasses, or sugar, or of some syrup or sap, including all dilutions or mixtures.
>
> "Proof spirits is liquor containing one-half of its volume of alcohol of a specific gravity of seven thousand nine hundred and thirty-nine ten-thousandths at fifteen degrees centigrade. A proof liter means liter of proof spirits." (As amended by Republic Act No. 592)

To our mind, the evident intention of Congress in eliminating from section 133 of the National Internal Revenue Code the all-embracing phrase "and the tax shall attach to this substance as soon as it is in existence as such . . . x x x " was to subject to specific tax not all kinds of alcoholic substances, but only distilled spirits as finished products, actually removed from the factory or bonded warehouse. We gather this purpose of Congress in enacting this particular amendment from the following portions of the speech of Senator Carlos P. Garcia which was delivered on the floor of the Senate during the discussion of House Bill No. 1443 (now Republic Act No. 592) when he proposed the elimination of the above-mentioned phrase:

> "But one thing that I would like to make of record is that I am not willing to go full way with those who seek to overtax our people with the idea of improving the economics of this country. We will have no more economics to improve if by overtaxation we will drive business of this country out of the field and we are going to nip in the bud the industries that are beginning to sprout in this country under the climate of independent national atmosphere.
>
> x x x x
>
> "That is why, Mr. President, in Section 1 of this Bill now under consideration, I have some serious objections to the provisions where all kinds of alcoholic substance which falls under the definition of proof spirits in the last paragraph of the same Section 1 of the proposed measure are taxable because this is one of those that I consider of deterrent effect to the industrialization of this country . . . . ." (Senate Diario No. 6, Jan. 15, 1951, Original, 4th Special Session; underscoring supplied).

Obviously, the decision of the respondent Collector of Internal Revenue to assess and demand the payment of the specific tax on the alcohol lost thru evaporation prior to the approval of Republic Act No. 592 is correct and in accordance with law. The all-embracing phrase "and the tax shall attach to this substance as soon as it is in existence as such, whether it be subsequently separated as pure or impure spirits, or be immediately or at any subsequent time transferred into any other substances either in process of original production or by any subsequent process" was then a part of section 133 (Specific tax on distilled spirits) of the Tax Code, and its wording is so clear and explicit as to remove all doubts that the specific tax already accrued and attached to the alcohol before a portion of the same was lost thru evaporation. Therefore, the petitioner herein is liable for the payment of the same, in the amount of ₱672.15 (Thompson vs. U.S., 142 U.S. 471), computed as follows:

Losses in rectifying rectified alcohol from June 7, 1950 to August 9, 1950 -------	691 proof liters
Times the rate of tax (See Rep. Act No. 219) --	x .45
Specific Tax Due ----------	₱310.95
Losses in rectifying rectified alcohol from December 2, 1950 to December 29, 1950 --------------------	602 proof liters
Times the rate of tax (See Rep. Act No. 589) --	.60
Specific tax due ----------	₱361.20

Total amount of specific
tax due ------------------ ₱672.15

However, with respect to the balance of the specific tax demanded amounting to ₱153,990.95 on the 219,753 proof liters of alcohol which were lost thru evaporation after January 1, 1951, the Court believes and so holds that the petitioner is not liable therefor. The intention of Congress in removing the words "and the tax shall attach to this substance as soon as it is in existence as such x x x x" from section 133 of the National Internal Revenue Code, may be inferred from the aforecited explanation of Senator Carlos P. Garcia. After the amendment of said section by Republic Act No. 592, the specific tax on distilled spirits did <u>not</u> immediately attach upon the alcohol as soon as it existed as such. Inasmuch as no tax accrued on the alcohol before the same was lost thru evaporation, no specific tax could be due and payable thereon. As will be seen from the amendment, the specific tax accrues only upon the manufactured distilled spirits which is removed from the factory for domestic sale and consumption.

Let us now view the question from the standpoint of our national economy.

Local as well as foreign economists are agreed that in order to stabilize our government finances, new industries need be given the necessary impetus. Realizing such need, Congress saw fit to enact a law exempting new and necessary industries from <u>all</u> taxes under certain conditions. But this is not enough. Government protection should extend as well to establish industries. They should be given the necessary encouragement to manufacture quality products that would stand competition in foreign markets. This is one way of conserving our dollar reserve. With this in mind, we find the interpretation given by the Bureau of Internal Revenue of section 133 of the National Internal Revenue Code after its amendment by Republic Act No. 592, much too stringent and unreasonable. It deters rather than encourages local manufacturers from producing high quality products.

From the declarations of chemists of other distillery plants such as the "Four Feathers", "La Fortuna", and "La Corona", the respondent tried to prove that the alcohol purchased from local centrals which comes in different grades needs no further rectification and distillation and that the same could be used as is in the manufacture of liquors and wines — as in fact most of them have been doing — after subjecting the raw material to the so-called methanol test. These witnesses declared that the wines and liquors produced by their respective distilleries with this kind of alcohol as basic material are safe enough for human consumption without any damaging effects. Respondent seems to labor under the theory, judging by what these witnesses have declared, that since the alcohol being sold by the different centrals to distillery plants which comes graded as "cabezas", "buen gusto", "fino" and "super fino" is good enough for other wine distilleries in the manufacture of their finished products without the necessity of further rectification and distillation, it should be usable as well for the herein petitioner. Thus, the respondent would now lay the blame entirely to petitioner for sustaining heavy losses due to evaporation in the process of further rectification and distillation which it has chosen to do in order to maintain the high standard which it has set for its finished products. In other words, the theory of the respondent seems to be: Why expose a substantial portion of the alcohol which you acquired from the two sugar centrals to loss thru evaporation simply to produce quality wines and liquors when you could just as well have followed the usual and more profitable manufacturing process of other wine producers? Antonio G. Palanca, Assistant General Manager and Chemist of the La Tondeña, Inc. has ably answered this point to the satisfaction of the Court. There is no dispute between the parties that the petitioner actually lost thru evaporation during the process of re-rectification and re-distillation the amount of 221,046 proof liters of alcohol during the period from June 7, 1950 to February 27, 1954. According to witness Palanca, his company which is considered one of the oldest distilleries in the Philippines, has endeavored and is still endeavoring to produce at all cost quality drinks that could compete with the best of other countries such as the Puerto Rican rum; that for this purpose, since the alcohol bought from the different centrals come in different grades, the petitioner without taking any chances has invariably subjected the same to further rectification at its distillery plant using the famous Barbit rectifying column; that on several occasions the petitioner was billed by the Central Azucarera Don Pedro and the Talisay-Murcia Sugar Central for alcohol supposedly of high test when actually, after examination, it turned out to be of the lowest type of alcohol with plenty of impurities; that the process of further rectification though expensive and tedious has increased the sales of the petitioner by 95%, averaging ₱800,000.00 to ₱1,000,000.00 monthly; that the process adopted by the petitioner has made its "Manila Rum" one of the best in the world and is now being exported to foreign countries; and, that further rectification of the alcohol bought from the local centrals is necessary because the consuming public has become more and more quality conscious.

Under the circumstances, as explained by witness Palanca, it would be unreasonable to insist that the petitioner adopt the crude methods employed by other local distilleries when the manufacturing process adopted by the petitioner has brought dividends to itself in the form of increased sales and to the Government, additional taxes and increased exports.

To the local manufacturers we say, it is not enough to produce something that is fit for human consumption. They should strive as well to improve their products and manufacture merchandise of high quality that would stand foreign competition.

In conclusion, we find and so hold that the petitioner is not entitled to claim for deduction, in the computation of the specific taxes, alcohol which were lost through evaporation in the process of re-rectification of low-grade alcohol prior to January 1, 1951, and as such is liable for the specific tax on the 1,293 proof liters so lost, or the sum of ₱672.15. However, from January 1, 1951, when Republic Act No. 592, took effect, the petitioner is no longer subject to the payment of any specific tax on alcohol lost in the process of re-rectification of such low-grade alcholol and in consequence therefor, the petitioner may not be required to pay the specific tax on the remaining 219,753 proof liters involved in this case, which were lost after said date.

IN VIEW OF THE FOREGOING CONSIDERATIONS, the decision of respondent Collector of Internal Revenue, dated May 8, 1954, is hereby modified, and petitioner La Tondeña, Inc., is hereby ordered to pay the respondent Collector of Internal Revenue the sum of ₱672.15, by way of specific tax. However, with respect to the balance of the assessment amounting to ₱153,990.95, which corresponds to the period after January 1, 19, 1951 and up to February 27, 1954, pursuant to Republic Act No. 592, the petitioner is declared exempt from liability for the specific taxes assessed therefor. Without pronouncement as to costs.

SO ORDERED.

Manila, Philippines, December 7, 1955.

AUGUSTO M. LUCIANO
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

ROMAN M. UMALI
Associate Judge

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