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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

VICENTE VELOSO YAP HOE,
Petitioner,

- versus -

C.T.A.
CASE NO. 514

June 25, 1959

COLLECTOR OF INTERNAL
REVENUE,
Respondent.

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DECISION

This is an appeal by petitioner from the decision of respondent denying the former's claim for refund of the sum of ₱30,043.16, representing alleged overpayment of the advance sales tax on umbrella handles and tips made of celluloid imported by petitioner and used in the manufacture of umbrellas for sale.

It appears that petitioner is a manufacturer of umbrellas. He imports from abroad umbrella handles and tips made of celluloid. From the third quarter of 1956 to the first quarter of 1957, he imported celluloid umbrella handles and tips with a total landed cost of ₱81,318.46 on which he was required to pay an advance sales tax of ₱36,768.52. This amount of ₱36,768.52 was arrived at by adding the mark-up of 50% to the landed cost and applying the percentage tax of 30% to the total of the landed cost and the mark-up, in accordance with Sections 183(B) and 186(d) of the Revenue Code. (See Stipulation of Facts dated February 19, 1959.) Petitioner contends that the rate of tax applicable is 7% which must be applied to the landed cost plus the mark-up of 25%, pursuant to Sec-

140

tions 183(B) and 186, and not 30% of the landed cost plus the mark-up of 50%.

The law (Sections 184-186 of the Revenue Code) classifies articles subject to the sales tax into three categories and imposes different rates of tax on each class, to wit: (a) from 50% to 100% on articles classified as luxuries (Sec. 184); (b) 30% on articles classified as semi-luxuries (Sec. 185); and (c) 5% and 7%, as the case may be, on articles classified as ordinary (Sec. 186). The rates of sales tax provided in Sections 184-186 of the Revenue Code are imposed on original sales of articles by manufacturers and producers. The same rates are applicable to imported articles, pursuant to Section 183(B). However, while the sales tax imposed by Sections 184-186 is based on the "gross selling price or gross value in money of the articles so sold" by the manufacturer or producer, the advance sales tax on imported articles provided in Section 183(B) is based on the total of the landed cost of said articles plus the corresponding mark-up. (See Mayon Motors, Inc. v. Collector of Internal Revenue, C.T.A. No. 413, December 27, 1958.)

In the case of a manufacturer who imports raw materials for use in the manufacture of articles for sale, he is required to pay the advance sales tax on the raw materials, but he is permitted to deduct the cost thereof in computing the tax on the gross selling price of the manufactured articles. This is in consonance with the intent and purpose of the law to impose the sales tax only once, that is, on original sales of articles by the manufacturer, producer or importer. However, Republic Act No. 1612 amended, among others, Sections 184-186 by providing that the cost of the raw materials is deductible from the gross selling price of the manufactured articles only when the raw materials are subject to the same rate of tax as the manufactured articles.

> "(d) Deductibility of cost of raw materials. - Prior to the enactment of Republic Act No. 1612, the total costs of raw materials on which the sales tax had been previously paid is deductible from the gross selling price of the articles manufactured therefrom, regardless of whether or not the raw materials have been taxed under the same section to which the manufactured articles belong. Under the amendatory Act, however, the cost of raw materials is now deductible only when they have been previously taxed under the same section to which the manufactured articles belong." (Page 28, B.I.R. General Circular No. V-227, September 7, 1956.)

There is no question that as a manufacturer of umbrellas with celluloid handles and tips petitioner is subject to the tax of 7% of the gross selling price of said articles under Section 186, umbrellas not being enumerated in either Section 184 or Section 185. Umbrellas cannot be classified under Section 185(d) because celluloid is not "the component material of chief value" of umbrellas. However, as petitioner imports the celluloid handles and tips, he is subject to the advance sales tax on said articles based on the landed cost thereof plus the corresponding mark-up. The sole issue presented for our consideration is whether the celluloid umbrella handles and tips imported by petitioner and used in the manufacture of umbrellas are subject to the advance sales tax of 30% of the landed cost of the articles plus the mark-up of 50%, as contended by respondent, or to the tax of 7% of the landed cost plus the mark-up of 25%, as contended by petitioner.

Petitioner relies upon a ruling of the Collector of Internal Revenue dated March 12, 1951 wherein it was held that celluloid handles and tips for use in the manufacture of umbrellas, when imported by the manufacturer himself, were subject to the advance sales tax of 7% of the landed cost thereof plus the mark-up of 25%. (See Annex A of the Stipulation of Facts, February 19, 1959.) On the other hand, respondent claims that the ruling of March 12, 1951 was revoked by the ruling of September 17, 1956, the pertinent portion of which reads as follows:

> "In answer to your letter of even date, I have the honor to inform you that celluloid umbrella handles and tips imported for use as raw materials in the manufacture of umbrella are subject to an advance sales tax at the rate of 30%, based on the total landed cost thereof plus 50% mark-up, pursuant to section 183 (b), in relation to Section 185(d) of the Tax Code, both as amended by Republic Act No. 1612 which took effect on August 24, 1956." (Annex B of the Stipulation of Facts.)

The revocation of the ruling of March 12, 1951 is premised upon the amendments to the Sales Tax Law introduced by Republic Act No. 1612. We quote from the decision of respondent under review:

"In reply, I have the honor to inform you that the above rulings of this Office were based on the provisions of the National Internal Revenue Code prior to their amendment by Republic Act No. 1612 which took effect on August 24, 1956. Inasmuch as the celluloid umbrella handles and tips were imported by your client after the effectivity of Republic Act No. 1612, the tax incidents thereon must be governed by the said law.

"Prior to the enactment of Republic Act No. 1612, the sales tax law permitted in effect the taxability of articles classified under section 184 and 185 at the rate established under section 186 of the Tax Code when they were used as raw materials in the manufacture of ordinary articles by allowing the deduction of the cost of the raw materials taxed under any of the aforesaid sections of the Tax Code from the gross selling price of the finished articles. Congress, however, in passing Republic Act No. 1612, repealed these provisions of the old law and provided that only the cost of materials enumerated in the respective sections 184, 185 and 186 of the Code may be deducted from the gross selling price of the manufactured articles enumerated therein, with the certain exceptions not material to this case. x x x .

"Furthermore, the intention of Congress to tax luxury articles used as raw materials in the manufacture of ordinary merchandise at a higher rate than the finished articles, is shown by the absence of a provision in section 186 of the Tax Code similar to that inserted by Republic Act No. 1612 in sections 184 and 185 that any part or accessory of the articles enumerated therein shall be taxed at the same rate as the finished articles. Impliedly, therefore, any part or accessory of the articles taxed under section 186 can be taxed at the rate provided for under sections 184 and 185 of the Tax Code." (Decision of respondent dated December 2, 1957, pp. 36-38, B.I.R. records.)

The provision added to both Sections 184 and 185 by Republic Act No. 1612 referred to in the deci-

156
48

sion under review reads:

> "Any part or accessory of the above-mentioned articles shall be taxed at the same rate as the finished articles."

Although Section 186 was also amended by Republic Act No. 1612, Congress did not see fit to add to said section a provision similar to the one quoted above. From this it is inferred that it was the intention of Congress to place manufacturers of articles taxable under Section 186 on a footing different from that of manufacturers of articles taxable under Sections 184 and 185. It is, therefore, pertinent to inquire into the facts determinative of the congressional purpose.

The question in regard to the rates of tax applicable to raw materials classified under Sections 184 and 185 and used in the manufacture of articles taxable under Section 186 was raised as far back as 1949. Although the Collector of Internal Revenue then was of the opinion that such raw materials were properly taxable at the same rates as the manufactured articles, he sought the confirmation and approval of the Secretary of Finance before rendering his decision. The second indorsement of the Collector to the Secretary of Finance dated May 27, 1949, reads as follows:

> "Respectfully returned to the Honorable, the Secretary of Finance, Manila.
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> "The Cromwell Manufacturing Co. is a domestic corporation engaged in the manufacture of toilet preparations, soap, toothpaste, talcum powder, and alcoholic products. The principal ingredients used in the manufacture of these articles are

imported from abroad, such as essential oils, aromatic chemicals and flavoring extracts on which the manufacturer pays the advance sales tax at the rate of 30% prescribed in section 184(c), in relation to section 183(B), of the National Internal Revenue Code, as amended. In the basic communication, the Cromwell Manufacturing Co. is protesting against the collection of the 30% advance sales tax on essential oils, aromatic chemicals and flavoring extracts used in the manufacture of soap, toothpaste and talcum powder on the ground that, under the law, original sales of soap, toothpaste and talcum powder are subject only to the 5% sales tax under section 186 of the Revenue Code. By paying the advance sales tax of 30% on raw materials used in the manufacture of soap, toothpaste and talcum powder, it is alleged that the company is being made to pay more than what is necessary. In fact, as of the end of March, 1949, it had an accumulated excess payment of the advance sales tax in the amount of ₱43,086.38, which amount 'will continue to increase quarter by quarter unless the abovementioned discrepancy is corrected'. It is claimed that 'it cannot afford to have this amount of capital tied up, as we need the funds for the proper operation of our business.'

"It is likewise alleged that the collection of 30% advance sales tax on raw materials imported from abroad for use in the manufacture in the Philippines of articles which are subject to tax at the rate of 5% places local manufacturers at a great disadvantage as against importers of similar articles manufactured abroad in the sense that the importers merely pay the advance sales tax of 5% while local manufacturers pay 30% advance sales tax on the raw materials and at the same time pay 5% advance sales tax on their output actually removed from their factory or warehouse. (Section, Revenue Regulations No. V-3).

"The law applicable to this case is section 183(b) of the National Internal Revenue Code, which reads as follows:

> '(B) Advance payment of sales tax on imported and locally produced and manufactured articles.- In the case of imported articles, the percentage taxes established in sections one hundred eighty-four, one

> hundred eighty-five, and one hundred eighty-six of this Code shall be paid in advance by the importer, in accordance with regulations promulgated by the Secretary of Finance and prior to the release of such articles from customs' custody, based on the total value thereof at the time they are received by the importer, including freight, postage, insurance, commission, customs duty, and all similar charges. In the case of locally produced or manufactured articles, the percentage taxes established in the said sections shall likewise be paid in advance on the total value thereof prior to removal from the producer's or manufacturer's warehouse. The amount so paid in advance in accordance with this sub-section shall be credited against the percentage taxes due on the sales by the taxpayer for each calendar quarter.'

This section treats of 'imported articles' and makes no distinction between articles used or intended to be used as raw materials and already finished articles which are imported and sold locally as such. Section 2 of Revenue Regulations No. V-3 also makes no provision for imported articles which are used as raw materials in the manufacture of other articles in the Philippines by the said manufacturers. Accordingly, this Office has construed section 183(b) as applicable to all imported articles irrespective of whether or not they are used or intended to be used as raw materials or for sale as such. However, upon a more careful consideration of the case, particularly the points raised by the Cromwell Manufacturing Co., there appears to be justification in the suggestion that imported articles which are intended for use as raw materials in the manufacture of articles which are subject to the sales tax at the rate of 5% should also be held subject to the advance sales tax at the same rate. In other words, the rate of advance sales tax applicable to a given kind of article should be made to depend upon the rate of the sales tax applicable to the manufactured article in order to place local manufacturers on the same footing as importers of the same or similar articles. Such an interpretation would not, it is believed, be contrary to the express provisions of sections 183(b) and 184-186 of the Revenue Code.

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"In view of the foregoing, this Office will interpose no objection to authorizing the Commissioner of Customs to collect the advance sales tax on imported articles for use as raw materials in the manufacture of other articles at the rates prescribed in sections 184-186 of the National Internal Revenue Code, as amended, depending upon the use to which such articles are to be put by the importer, if authorized by that Department, subject to the condition that before allowing an importer to pay the advance sales tax of 5% on articles, which would otherwise be subject to tax at the rate of 30%, for use in the manufacture of articles subject to tax at the rate of 5%, a written request therefor should be made and filed with this Office covering each shipment stating, among other things, the nature of the articles and the use to which they are to be put, accompanied with the bill of lading and other supporting papers. In the case of articles which are imported from abroad for use in the manufacture of articles subject to specific tax, this Office will authorize the release of such articles from the customhouse or the post-office without the prepayment of the compensating tax or advance sales tax subject to the requirements mentioned above." (Underscoring supplied.)

The opinion and recommendation of the Collector of Internal Revenue quoted above were confirmed and approved by the Secretary of Finance in the latter's third indorsement, dated June 11, 1949, which reads:

"Respectfully returned to the Collector of Internal Revenue, Manila, concurring in the view expressed in the last paragraph of his next preceding indorsement to the effect that imported raw materials to be used in the manufacture of articles intended for sale shall be subject to advance sales tax at the rates prescribed in sections 184, 185 and 186 of the National Internal Revenue Code for the finished articles, subject to such terms and conditions as the Collector of Internal Revenue may impose. No objection is offered to the release, without prepayment of compensating tax or advance sales tax , of imported articles to be used in the manufacture of articles subject to specific tax, under such terms and conditions as the Collector of Internal Revenue may impose, provided that periodic verification of the stock of supplies and raw materials of the particular importers is made in order to insure that such imported articles withdrawn tax-free are not diverted or used for other purposes.

"The Cromwell Cosmetic Export Co., Inc. has been requested to get in touch with that Office in order that the procedural requisites for the withdrawal of articles imported by them for use in the manufacture of other articles may be arranged with that Office."

Obviously, the ruling of the Collector of Internal Revenue of March 12, 1951 to the effect that imported celluloid handles and tips, which are used in the manufacture of umbrellas, are subject to the advance sales tax of 7% of the landed cost plus the mark-up of 25% is merely a reiteration of the administrative practice established in 1949 by the Collector with the concurrence of the Secretary of Finance. However, in the case of automobile manufacturers, it was held that raw materials, or parts and accessories of automobiles, imported from abroad for use in the manufacture of automobiles were taxable under Section 186, although automobiles were taxable under Sections 184 and 185, and that the cost of said raw materials were deductible from the gross selling price in computing the tax on the sales of such automobiles. The opinion of the Secretary of Finance of July 2, 1951 in the case of Fabar, Incorporated is reproduced below in full:

"Reference is made to your letter dated June 27, 1951 wherein a ruling is requested whether or not your industry, assembling automobiles and performing other work necessary to this process, may be considered manufacturing, taxable under section 184 or 185 of the National Internal Revenue Code, as amended, and in the affirmative case, whether the cost of the materials that enter into the manufacture of the automobiles, on which the sales tax prescribed in section 186 of the National Internal Revenue Code had been paid, is deductible from the gross selling price of the manufactured automobiles.

"It appears that you import from the United States automobile parts, accessories and other raw materials and assemble them in your plant in Manila. This process involves not only fitting operations but also other processing work necessary to produce a completed automobile. Under these facts, this Department is of the opinion that you are a manufacturer of automobiles within the meaning of sections 184 and 185 of the National Internal Revenue Code, as amended.

"The next question is whether or not the cost of the materials, whether imported or locally purchased, that enter into the manufacture of the automobiles, where the tax on such materials under section 186 of the Tax Code had been previously paid, is deductible from the gross selling price of the manufactured automobiles taxable under section 184 of the same Code.

"Section 184 provides that 'where the articles 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 the manufactured articles.' It would seem from this provision of section 184 of the Revenue Code that only the cost of articles previously taxed under that section when used in the manufacture of articles taxable thereunder may be deductible from the gross selling price or gross value in money of the manufactured articles. The provision in section 185 in regard to the deductibility of the cost of materials is broader because it authorizes the deduction of the cost of materials previously taxed under that section and section 186. On the other hand, the

130
112

provision in section 186 is the same as that contained in section 184 in that it limits the materials the cost of which is deductible from the gross selling price or gross value in money of the manufactured articles only to those materials previously taxed under that section.

"A close scrutiny of the provisions of sections 184, 185 and 186 of the Revenue Code referring to the deductibility of the cost of raw materials from the gross selling price or gross value in money of the manufactured articles reveals that the purpose behind those provisions is the imposition of a single sales tax on the articles enumerated therein for, without these provisions, materials already taxed would again be subject to tax when used in the manufacture of other articles. A strict interpretation, however, of each provision would be unjust in some cases and lead to absurd results. For instance, while the cost of raw materials previously taxed under sections 185 and 186 are deductible from the gross selling price of manufactured articles taxable under sections 185, raw materials previously taxed at higher rates under section 184 would not be deductible if the provision in question were to be given a literal interpretation. Similarly, the cost of raw materials previously taxed under sections 184 and 185 would not be deductible from the gross selling price of manufactured articles taxable under Section 186. Obviously, it culd not have been the intention of Congress to allow deduction where the raw materials are taxable at lower rates and to deny the same privilege where the raw materials are taxable at higher rates.

> 'Even the rule of strict construction will not be so closely followed as to make unreasonableness. Often has has it been stated in effect, that the intention of the Legislature is the law. Novelty may have gone from this expression, but cogency is with it yet. The language of the law is inartificial, nevertheless the real purpose of the Legislature, if that purpose be discernible from its statute, will prevail over the literal import of the words employed. There is nothing hallowed about the rule of strict construction; there should be nothing wrongful. Nor is it purely mechanical. It is a very practical rule. Its oneness of aim is to effectuate, never to thwart, legislative intention. In the main it works

well. Being a good rule it will work both ways. When it would be destructive of legislative intent, then the reason for using it ceases. Reasoning and judgment, not mere bald literalness of statutory phrasing, must guide and control research for a judicial legislative design.' (Inhabitants of Whiting v. Inhabitants of Lubec, 121 Me. 121, 115 Atl. 896, 899 (1922), cited in 3 Sutherland Statutory Construction, p. 42.)

"So that the purpose and intent of the law might be fully and justly served, the only reasonable interpretation which could be given to the provisions in question would be to allow the deduction of the cost of the raw materials previously taxed under either of the three sections (sections 184, 185 and 186) in determining the taxable gross selling price of the manufactured articles.

"Resolving, therefore, the second question propounded by you, this Department is of the opinion that the cost of raw materials on which the tax under section 186 had been paid may be deducted from the gross selling price of automobiles manufactured by you out of such raw materials, whether such automobiles are taxable under section 184 or under section 185."

It thus appears that with respect to manufacturers of articles taxable under Section 186, imported raw materials, although they come under any of the articles enumerated in Section 184 or Section 185, were taxed under Section 186, that is, at the same rate as the manufactured articles. On the other hand, manufacturers of articles taxable under Sections 184 and 185, such as manufacturers of automobiles, were held subject to tax under Section 186 in regard to the raw materials imported and used in the manufacture of such articles. This was the administrative practice up to the enactment of Republic Act No. 1612, which was made effective on August 24, 1956. Congress was not apparently satisfied with the interpretation of the law affecting manufacturers generally under Sections 184 and 185 so that said sections were amended by Republic Act No. 1612 by adding a provision that "Any part or accessory of the above-mentioned articles shall be taxed at the same rate as the finished articles." However, Congress saw fit to maintain the administrative interpretation in regard to automobile manufacturers by providing "That parts and accessories of automobiles imported as replacements or as completely knocked down parts for the assembly of automobiles shall be subject to tax under section one hundred and eighty-six."

> "Under the amendment, parts and accessories of the articles enumerated in sections 184 and 185 are now subject to the same rate of tax as the finished articles. Before, parts and accessories of said articles were generally subject to 7% tax only.
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> "The only exception to the above are parts and accessories of automobiles imported as replacements or as completely knocked down parts for the assembly of automobiles which is taxed under section 186 at 7% only." (Page 28, B.I.R. General Circular No. V-227, Sept. 7, 1956.)

The intention of Congress is, therefore, quite clear, and that is to revoke the administrative interpretation of the Bureau of Internal Revenue and the Department of Finance in regard to manufacturers under Sections 184 and 185, except in the case of automobile manufacturers. To quote from the explanatory note accompanying H. B. No. 5809, which became Republic Act No. 1612:

> "By the proposed amendments, parts and accessories are made subject to the same rate of tax to which the finished articles are subject. This amendment will do away with the practice of certain importers who have actually been importing finished articles under the guise of spare parts. It is to be noted that under the existing provisions of sections 184 and 185, parts and accessories of articles taxed therein, unless specifically mentioned, are subject only to 7% sales tax. The practice of importing finished articles under the guise of spare parts have deprived the government of substantial revenue.
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> "The deductibility of the cost of raw materials taxed under section 186 from the gross selling price of the articles manufactured therefrom which is taxable under section 185 is removed in order to secure uniformity in the application of the provisions of sections 184, 185 and 186 and to erase all doubts respecting the extent and scope of the deductions provided for in these three sections."

In revoking the administrative interpretation given to Sections 184 and 185, did Congress also intend to revoke the administrative interpretation given to Section 186? We do not think so. Congress was well aware of the interpretation given to Sections 184, 185 and 186 by the administrative officials charged with their enforcement. When it decided to amend Sections 184 and 185 only leaving Section 186 as it was before the enactment of Republic Act No. 1612, except as to other matters unrelated to the question here at issue, it is a strong indication that the administrative interpretation given to Section 186 has received congressional approval. Any inference that it was the intention of Congress to alter the administrative practice is without legal basis. That it was the intention to validate the administrative practice as regards manufacturers under Section 186 may also be gleaned from the explanatory note accompanying the bill which became Republic Act No. 1612. There it was plainly stated that the amendments to Sections 184 and 185 were intended "to secure uniformity in the application of the provisions of Sections 184, 185 and 186 and to erase all doubts respecting the extent and scope of the deductions provided for in these three sections." The interpretation which respondent has given to these three sections in his decision under review would thwart this legislative purpose.

There is another important point which can not be overlooked. The reason for the requirement that the raw materials imported by manufacturers for use in the manufacture of articles for sale should be taxed at the same rate as the finished articles is not only to place local manufacturers on the same footing as importers of ready made or manufactured articles but also to give them preferential treatment, whenever possible, they being dollar-producing or dollar-saving industries. Republic Act No. 901 exempts from all taxes new and necessary industries established in the Philippines. Sections 183(B) and 190 of the Revenue Code provide for the exemption from the advance sales tax and the compensating tax of articles imported by manufacturers for use in the manufacture of articles for export. And Republic Act No. 1823 exempts from the accumulation of earnings and profits tax under Section 25 of the Revenue Code the undistributed earnings and profits of corporations invested in industries which are dollar-producing or dollar-saving. (See B.I.R. General Circular No. 249, July 11, 1957.) The decision of respondent in this case would nullify that purpose. The effect of respondent's decision is to require manufacturers of umbrellas to pay the sales tax of 7% of the gross selling price thereof in addition to the 30% advance sales tax on umbrella handles and tips made of celluloid. On the other hand, an importer of umbrellas is subject only to the advance sales tax of 7% of the landed cost of such umbrellas plus the corresponding mark-up of 25%, irrespective of whether or not the handles and tips are made of celluloid. This interpretation would pave the way for the total elimination of the umbrella manufacturing industry in the Philippines to give way for importers of said articles, a result which is surely not in keeping with the legislative policy of giving encouragement to local industries.

But it is argued that "Congress had in mind that only ordinary articles should be used in the manufacture of articles taxable under Section 186." This argument would perhaps be valid if there is a prohibition against the importation of ordinary articles made partly of luxury or semi-luxury materials.

We are, therefore, of the opinion that celluloid handles and tips imported for use by the importer in the manufacture of umbrellas are taxable at the rate of 7% based on the landed cost of such celluloid handles and tips plus the mark-up of 25%.

We find, however, from the records that the overpayment being claimed by petitioner in the amount of ₱30,043.16 is not correct. From the stipulation of facts it appears that the total landed cost of the celluloid handles and tips imported by petitioner is ₱81,318.46. Adding 25% to the landed cost of ₱81,318.46, which is ₱20,329.62, the total taxable value subject to tax is ₱101,648.04. The advance sales tax due is, therefore, 7% of ₱101,648.04, or ₱7,115.37. Since petitioner paid ₱36,768.52, as admitted by the parties in the stipulation of facts, the amount overpaid is the difference between ₱36,768.52 and ₱7,115.37, or ₱29,653.15 and not ₱30,043.16.

WHEREFORE, the decision appealed from is reversed. Respondent is hereby ordered to refund to petitioner the sum of ₱29,653.15, without pronouncement as to costs.

SO ORDERED.

Manila, June 25, 1959.

ROMAN M. UMALI
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

AUGUSTO M. LUCIANO
Associate Judge

129
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