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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

USIPHIL, INC.,
Petitioner,

- versus - C.T.A. CASE NO. 3054

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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USIPHIL, INC.,
Petitioner,

- versus - C.T.A. CASE NO. 3084

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

9/22/82

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D E C I S I O N

These are two (2) petitions for review (CTA Cases Nos. 3054 and 3084) filed by petitioner, Usiphil, Inc., against respondent Commissioner of Internal Revenue seeking the refund of the amounts of ₱44,451.48 and ₱913,067.38 as 7% manufacturer's sales taxes it paid for the last quarter of 1977, and for the years 1978 and 1979, respectively.

The facts and issues being the same, these cases were jointly heard by the Court.

Petitioner is a domestic corporation organized and existing under and by virtue of the laws of the Republic of the Philippines. It has its principal place of business at Buendia Avenue, Makati, Metro Manila. According to the records (pp. 58-59, CTA rec.) of these cases, the facts as shown therein are as follows:

> "The petitioner, for the last quarter of 1977 and for the years 1978 and 1979, had filed on a quarterly basis, Business (Percentage) Tax Returns. Included in these business tax returns are the manufacturer's percentage taxes. xxx xxx xxx the petitioner paid the amounts due thereunder, including manufacturer's percentage taxes.
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> "The manufacturer's taxes that the petitioner paid for the last quarter of 1977 and for the years 1978 and 1979 pertain to the sales of the reconditioned component assemblies of tractors under its Parts Exchange Service Program. The petitioner's Parts Exchange Service Program (PES Program) is a program supporting the sales of caterpillar tractors, machineries and heavy equipment which are being imported from the U.S. and Japan in pursuit of its trading business. Similarly, brand new replacement parts for these tractors, heavy machineries and equipment are being imported from the U.S.A. and Singapore. Aside from making available brand new replacement parts, petitioner pursuing and implementing its PES Program, also sells reconditioned component assemblies which it had repaired."

On account of the above stated activities, petitioner paid the amount of ₱44,481.48 as manufacturer's sales tax for the last quarter of 1977 as evidenced by Revenue Tax Receipt No. 17386353 issued by the Central Bank of the Philippines dated January 12, 1978. However, at a later date, upon advice of its external auditor, it filed with the Commissioner of Internal Revenue a claim for refund or tax credit for said amount paid as manufacturer's sales tax on the ground that petitioner is not a manufacturer and, therefore, is not subject or liable to the manufacturer's sales tax for the said period. Subsequently, it filed another claim for refund or tax credit with respondent Commissioner of Internal Revenue in the amount of ₱913,067.38, representing manufacturer's sales tax for the years 1978 and 1979 on the similar ground that petitioner is not a manufacturer and is not subject to manufacturer's sales tax. However, inasmuch as no action was taken by respondent on both claims, petitioner filed the aforesaid petitions for review.

The only issue involved in both cases is whether or not under the facts of these cases petitioner is a manufacturer, in contemplation of Section 187 (x) of the National Internal Revenue Code, when it repairs, rebuilds, and/or assembles component assemblies of tractors and heavy equipment acquired under its PES Program and sells the same to its customers. In the affirmative, petitioner is legally liable for the manufacturer's sales tax it had paid during the periods in question. If not, petitioner is not liable thereto and its claim for the tax refund or credit of the manufacturer's sales tax paid is legally in order.

In respondent Commissioner's answers to the petitions for review in these two (2) cases, he had strongly anchored his position on the provisions of said Section 187 (x) of the Tax Code, which he asserted, placed petitioner in the position of a manufacturer subject to manufacturer's sales tax. So that, therefore, as such manufacturer, it is liable to the manufacturer's sales taxes which it paid to the government. Section 187 (x) of the National Internal Revenue Code provides as follows:

> "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 a 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 such process alters the quality of any such raw material, or manufactured or partially manufactured product as to reduce it to marketable

> shape or prepare it for any 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 such manner that the finished product of such process or 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 alters 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."

During the pendency of these cases before this Court, respondent Commissioner of Internal Revenue ordered, under his Memorandum Order dated July 16, 1980 (p. 23, BIR rec.), and also under his 1st Indorsement of September 4, 1980, (p. 56, BIR rec.), Revenue Examiners Celso P. Razal and Apolonio G. Santos to investigate the feasibility or nonfeasibility of the claim of Usiphil for the refund or tax credit of the amounts representing manufacturer's sales taxes paid by it for the periods in question. Said revenue examiners, upon receipt of the order, first and foremost, proceeded to, examined and investigated petitioner's Parts Exchange Service Program (PES, for short), documents, shop facilities, tools and other equipments, machineries, demonstration cut-outs and the undercarriage repair section found in the premises of petitioner. After a thorough administrative investigation of these two (2) cases (which took them all of the seven (7) months from July to November, 1980), said examiners submitted to the Commissioner of Internal Revenue a thorough and detailed report dated November 21, 1980 (pp. 18-21, BIR rec.) the pertinent, relevant and most important portions of which are quoted below:

> "1. That while the attached Amended Articles of Incorporation (Annex "A") appears to authorize the taxpayer to engage in several lawful activities, it is in fact <u>primarily engaged in trading</u>, as sole distributor in the Philippines of "Caterpillar" brand of heavy machineries and equipment it distributes. On both importations, xxx xxx xxx it pays the corresponding advance sales tax.
>
> "It also provides repair service of the machinery and equipment of their customers and also acts as broker between foreign suppliers and Philippine customers. xxx xxx xxx it pays the corresponding contractor's tax of 3% and the 6% commercial broker's tax. xxx xxx.
>
> "2. It renders repair service of the machinery and equipment purchased from it, and also for damaged portions thereof, when parts are brought in by their customers in their shops. They also send technicians to conduct repairs

of machinery and equipment in the field. Taxpayer supplies the labor and the replacement parts at the expense of their customers. xxx xxx xxx Taxpayer does not acquire ownership of the parts repaired. xxx xxx xxx They pay the contractor's tax of 3% on their gross receipts therefrom.

"3. That taxpayer was found to have been paying the manufacturer's sales tax during the period abovementioned on its sales of repaired replacement parts it had previously acquired through trade-ins from its customers. The trade-in of parts and the repair thereof is part of their PART EXCHANGE SERVICE PROGRAM under the management and control of the PES Department of their Product Support Division.

xxx xxx xxx the records of this Division and from interviews had with Mr. Ernesto Hernandez, the head of said Department, The Program's operation is described as follows:

'When a customer brings in a damaged part of a heavy machinery or equipment, the technical experts in the repair shop examine the extent of the damage. If it will entail extensive repairs and replacement of major parts, the customer is always advised to either scrap and part or have it repaired at the customer's expense. The reason for this is because the company as a matter of business policy, does not accept as trade-in <u>extensively damaged parts</u>. Business experience had taught them that such deals are not always a paying proposition. It will only accept trade-in parts with minor damage that would require slight repairs and replacement parts such as seals, gaskets, bussings, etc. In exchange of the traded-in parts, the customer is offered a brand new part or a second hand repaired part. Accordingly, the traded-in parts are repaired in their shop and carried again in their inventories. As a result, they maintain inventories of two categories, namely, the brand new parts and the second hand repaired parts. It was also observed that the brand new parts carry values substantially higher than the second hand parts.

"To verify the extent of the repairs made on traded-in parts and the nature of the repairs, we worked on their shop records, particularly their files on "COMPLETED JOB REPORTS". It clearly show the CORE VALUE (or trade-in value), THE NEW PARTS CONSUMED, the LABOR COST COLUMNS and the TOTAL COST COLUMNS which are self-explanatory as their titles indicate. We have, therefore, picked at random from their yearly files the enclosed "COMPLETED JOB REPORTS" marked as Annexes "F" and "F-1" to "F-14", inclusive, to obtain a clear picture of the acquisition, treatment, and disposition of all the elements involved in the operation.

"Very clearly, we ascertained that there is no manufacturing activity involved.

"4. That in the tour of the premises of the taxpayer, we saw no manufacturing facilities except for the usual tools, such as welding equipment, plumbing tools, chain blocks, various mechanical and electrical gadgets and several hand tools. We saw on deck for repairs at the time of our inspection turbo chargers, idler components, torque converters, carrier roller components, engines and heavy machinery, transmissions, track frames, cylinder heads as identified by their respective "PES" tags."

"As a result, we have come to the conclusion that subject taxpayer is not a manufacturer as defined under Section 187 (x) of the Tax Code. We buttress this statement with the following observation as summarized below:

'a. The parts accepted as trade-ins are the slightly damaged ones and were even usable before it was dismantled except for the reduced mechanical efficiency;

'b. The repairs done do not result in a new product because the part presented is a finished product by itself;

'c. The repairs done do not alter the original form and substance of the parts repaired and do not consign the same part for a special use other uses different from the original one; and

'd. That they could not have been engaged in manufacturing because they are not equipped with manufacturing facilities except for a repair shop as described above.

Moreover, quoted hereunder is a ruling of this office identified as "BIR Ruling No. 2, Series of 1959" wherein the facts cited which was the basis of the promulgation of said ruling fit snugly into the case at bar:

> 'Persons who purchase second hand automobiles which are fairly in running condition but who, prior to the resale thereof, make minor repairs thereon, such as changing minor spare parts with new ones; repairing minor damages on the body, such as scratches, general cleaning and polishing, which do not affect such changes in the vehicle as to practically remove all traces of their original appearance are essentially dealers subject to graduated annual fixed tax.
>
> We reiterate, therefore, that subject taxpayer has never been a manufacturer as contemplated under Section 187 (x) of the Tax Code.
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> xxx xxx xxx
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> Premises considered, it is, therefore, recommended that the total amount of ₱957,518.86 be refunded to the taxpayer pursuant to Section 292 in relation to Section 295(3) of the Tax Code, it being an erroneous payment." (Underlining ours.)

For his part, and at this juncture, respondent Commissioner of Internal Revenue seemed to find no merit, not only in the assertions of taxpayer, but also in the very findings of his revenue examiners, which strongly and singularly prove and upheld the claims of taxpayer that it is not a manufacturer subject to manufacturer's sales tax in these two (2) cases in question. Although the most recent on-the-spot investigation of the premises of petitioner USIPHIL, Inc. yielded negative results to the effect that petitioner was not found to be a manufacturer by Revenue examiners Celso P. Razal and Apolonio G. Santos, confirmed in their report to respondent (supra) when they stated that "(taxpayer) could not have engaged in manufacturing facilities except for a repair shop as described above (see also letter "d", p. 19, BIR rec., p. 7, this Decision), respondent Commissioner of Internal Revenue had pursued or taken a runabout, nay a diametrically opposed, position from that of his examiners by stating in effect" xxx that Usiphil has always considered itself as a manufacturer and has thus been paying the 7% tax on its taxable sales of completely rebuilt components, assemblies, machineries, engines, and other equipments. xxx" and assumed that this status and activity of petitioner could have been" xxx. made possible only with the use of highly specialized and sophisticated equipments and by following rigid factory specifications and technology by highly trained personnel." (pp. 103-104, BIR rec.)

It is important to note, in this connection, that in the arguments of the parties in support of their respective claims, respondent is of the belief that Section 187 (x) of the National Internal Revenue Code applies to petitioner as a manufacturer, while petitioner, on the other hand, says it is not. The respondent Commissioner of Internal Revenue and petitioner have therefore drawn two (2) divergent interpretations of said provision to bolster their respective positions.

The Court, at this point, now pauses and view the respective claims of respondent and petitioner from a very ideal vantage point.

Counteravailing testimonial evidence however has proven that petitioner sells reconditioned component assemblies or parts which it had previously repaired. (pp. 12-17, t.s.n., Feb. 6, 1981.) The customer acquires through sell the reconditioned component assembly by paying an amount which is equal to the net of the trade-in value of his worn out assembly. The worn out assembly shall be acquired in return by petitioner which will be repaired on its own account and at its expense; and when fully repaired or reconditioned, it will be carried in petitioner's inventory of reconditioned component assemblies ready for sale to its next customer having a worn out component (ibid, t.s.n.; *ibid.*) The worn out component assembly exchanged must be identical to the one delivered by petitioner and must be within repairable damage. (pp. 13, 34, *ibid.*)

The component assemblies or parts, referred to above, consist of charger, truck rollers, torque converters, torque dividers, engines, transmissions, cylinder heads, track frames, front idlers, track carrier rollers, and fuel pumps. (p. 15, t.s.n., *ibid*). No new products are turned out after these compnent assemblies have been completely repaired and their efficiency restored to the maximum. In the repair of the component assemblies or parts, the usual ordinary tools needed for their repairs are employed and these tools and equipments used are usually found in other repair shops. (p. 16, t.s.n., *ibid.*) Contrarily, we find no evidence to show the truth of respondent's conclusion that the component assemblies were rebuilt with highly specialized equipments and under rigid factory specifications and technology, which to us is merely based upon assumptions.

In analyzing Section 187 (x) of the National Internal Revenue Code in question, heretofore

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quoted, we are in full agreement with petitioner that said Section clearly provides for four (4) different modes of manufacturing and that the resulting procedures or modes of manufacture brings out products which are entirely different from the raw materials manufactured or partially manufactured products used in or composing the manufactured product. In other words, the manufactured product was brought about by the process of (1) altering by chemical or physical process, exterior texture, form or inner substance, quantity of the raw material or manufacture or partially manufactured product; and/or the (2) combination of the raw materials or manufactured or partially manufactured products with other materials or products of the same or different kind, either to (a) put the finished product for special uses which it cannot be put in its original condition; (b) or reduce it to marketable shape for any uses of industry; (c) or for the purpose of their sale or distribution to others and not for the manufacturer's own use or consumption. (Italics ours.)

As far as the evidence in these cases show, none of the four (4) modes of manufacturing was performed by petitioner, which to us is the simple act of making minor repairs of the component parts which is not one of the manufacturing processes. It neither altered by chemical or physical process, the component assemblies or parts nor combined these component assemblies or parts with other materials to form an entirely new manufactured product for sale or distribution to others. After repair, it is the same component assembly formerly damaged. It is, therefore, obvious that petitioner, in the repair of the component assemblies or parts, did not perform acts of manufacturing as defined under Section 187 (x) of the National Internal Revenue Code. Hence, it is not liable as a manufacturer for manufacturer's sales tax purposes.

Moreover, to bolster this conclusion, a cursory incursion into the lexical meaning of the word "manufacture" was made by this Court. The word "manufacture", a term found in Section 187 (x) of the National Internal Revenue, the provision of law here in question, means the operation of making wares or any product by hand, by machinery, or by other agencies; or anything made from raw materials, by the hands, by machinery, or by art, as clothes, iron, utensils, shoes, machinery, saddlery, etc. <u>Any useful product made directly</u> by human labor, or by the aid of machinery directed or controlled by human power, and either from raw materials or from materials worked up into a new form. Also the process by which such products are made or fashioned. To make or fabricate raw materials by hand or machinery or by art worked out into forms convenient for use. (Federico B. Moreno, Philippine Law Dictionary, 1972 Ed., p. 292; underlining ours.)

The Webster's Third New International Dictionary, 76th Ed., defines "manufacturer" as "one who changes the form of a commodity or who creates new commodity." (p. 1378; Italics ours.)

Again, the case of Manila Trading & Supply Co. vs. City of Manila, et al., 105 Phil. 581, 586-587, brought into focus a case cited therein, which is the City of Louisville vs. Louisville Tin & Stove Co., 186 S.W. 124, 125, in which latter case, it was aptly stated thus -

> "We do not understand that in order for a business enterprise to be a manufactory it is necessary for it to be engaged in the business of making completed articles from materials which are altogether raw. It is nonetheless a manufactory if, as in this case, it combines separate parts manufactured and completed by others with new materials which it itself cuts and fashions into proper shape, and thus produces an entirely new article suitable for use. xxx" (Underscoring ours.)

What then is the difference between manufacturing and repairing? In the case of Vicente Uy Chao vs. Aguilar, 103 Phil. 219, 222, it was pointed out that, "xxx. Repair is restoration to a sound or good state after decay, dilapidation, injury or partial destruction. It is essentially a process of reconstruction, or of broken or damaged parts of a structural whole. xxx." In its ordinary acceptation, therefore, the term repair must be understood to apply to the restoration of things after injury or partial destruction without there being a complete loss of identity of the thing being repaired.

Another case in point is Alburo vs. Villanueva, 7 Phil. 277, wherein it was stated that "xxx. A repair implies the putting of something back into the condition in which it was originally and not an improvement in the condition thereof by adding something new thereto, unless the new thing be in substitution of something formerly in existence and is added to preserve the original status of the subject matter of the repairs; xxx" (Underlining ours.)

Under the new International Webster's Dictionary, "recondition" is restoring to a good condition (as by repairing, replacing parts.)

By virtue of the foregoing underlying pronouncements and interpretations of the above terms, one can safely conclude that in repair or in reconditioning jobs, which petitioner actually did to the component assemblies or parts in this case, decidedly no new product was turned out by petitioner unlike in the case of actual manufacturing. Indeed, this brings us to the penaltiate conclusion that petitioner can be anything but not a manufacturer. Consequently, we are of the opinion, and so hold, that petitioner is not liable for the payment of 7% manufacturer's taxes in the sum of ₱44,451.48 for the last quarter of 1977, and ₱913,067.38 for the years 1978 and 1979.

WHEREFORE, respondent Commissioner of Internal Revenue is hereby ordered to refund or extend a tax credit to petitioner Usiphil, Inc., in the sums of ₱44,451.48 (CTA Case No. 3054) and ₱913,067.38 (CTA Case No. 3084), which the latter had erroneously paid as 7% manufacturer's sales taxes for the last quarter of 1977, and for the years 1978 and 1979, respectively, or a total sum of ₱957,518.86.

DECISION -
CTA CASES NOS.
3054 & 3084

No pronouncement as to costs.

Quezon City, Metro Manila, September 22, 1982.

CONSTANTE C. ROAQUIN
Associate Judge

I CONCUR:

Took no part

AMANTE FILLER
Presiding Judge

ALEX Z. REYES
Associate Judge