

**COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS.
AMERICAN RUBBER COMPANY AND COURT OF TAX APPEALS,
RESPONDENTS.[G.R. Nos. L-19801-03] AMERICAN RUBBER COMPANY,
PETITIONER, VS. T...**

G.R. No. L-19667. November 29, 1966

Ponente: REYES, J.B.L., J.

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REYES, J.B.L., J.:

These cases are brought on appeal from the Court of Tax Appeals by the State (G. R. No. L-19667) as well as by the American Rubber Company (G. R. Nos. L-19801, 19802 , 19803).

The factual background is the same in all four cases, and is not in controversy, having been stipulated between the parties.

Petitioner, American Rubber Company, a domestic corporation, from January 1, 1955 to December 31, 1958, was engaged in producing rubber from its approximately 900-hectare rubber tree plantation, which it owned and operated in Latuan, Isabela, City of Basilan. Its products, known in the market as Preserved Latex, Pale Crepe No. 1, Pale Crepe No. 2, Ribbed Smoked Sheets Nos. 1 and 2, Flat Bark Rubber, 2X Brown Crepe and 3X Brown Crepe, are turned out in the following manner:

The initial step common to the production of all the foregoing rubber products is tapping, i.e., the collection of latex (rubber juice) from rubber trees. This is done by the daily cutting, early in the morning, of a spiral incision in the bark of rubber trees and placing a cup below the lower end of the incision to receive the flow of latex. The collecting cup is filled after two hours. The tapper then collects the latex into buckets and carries them to the collecting shed. The tapper subsequently pours the latex collected into big milk cans. The filled milk cans are then taken in motor vehicles to a coagulating shed, also within the premises of petitioner's plantation, where the latex is strained into coagulating tanks to remove foreign matter such as leaves and dirt. After these initial steps, the processes vary in the production of the various rubber products mentioned above. Said processes are described here under.

Preserved Rubber Latex

Fresh latex is diluted with 5 to 5-1/4 ounces of ammonia per gallon of latex. The mixture is thoroughly stirred and then poured into metal drums. The addition of ammonia preserves the latex in liquid form and prevents its deterioration or its acquisition of a repulsive smell, and at the same time preserves its uniform color. Latex which has been thus artificially preserved in its liquid form generally lasts for about a month without spoiling. On the other hand, fresh latex in its original state lasts for only about two hours, after which it becomes spoiled.

Petitioner sells preserved latex only upon previous orders of customers who supply empty metal drum containers.

Pale Crepe Nos. 1 and 2 and Ribbed Smoked Sheets Nos. 1 and 2

To produce Pale Crepe Nos. 1 and 2 and Ribbed Smoked Sheets Nos. 1 and 2, the petitioner adds to the latex in the coagulating tank about 15 or 16 ounces of glacial acetic acid per gallon of latex. The mixture is stirred thoroughly. Thereafter aluminum partitions are placed crosswise inside the tank so that the latex will coagulate into uniform slabs. Acetic acid is added to the latex to hasten coagulation which otherwise takes place naturally, and to preserve its fresh state and color. The similarity in the production of Pale Crepe Nos. 1 and 2 and Ribbed Smoked Sheets Nos. 1 and 2 ends at the point of removing the coagulum (coagulated rubber sheets) from the coagulating tanks.

To produce Pale Crepe No. 1, the coagulum is passed through a series of rollers until the desired thickness is attained, whereupon it is moved to the air-drying house situated inside petitioner's plantation and hung for a period of about twelve or thirteen days to dry. There are no mechanical driers used; the air-drying is done naturally. As soon as the Pale Crepe is dried, the sheets are sorted; those which are of uniform pale color are classified as Pale Crepe No. 2, whereupon they are baled and stored, ready for the market.

Ribbed & Smoked Sheets Nos. 1 and 2 are produced practically in the same manner as Pale Crepe, except that the coagulum is passed only once through a roller provided with ribs after which the flattened and ribbed coagulum is removed to petitioner's smoke-house where it is hung and cured by exposure to heat and smoke from wood fires for about six or seven days. The resulting smoked sheets are sorted and classified dependent upon color and opaqueness into ribbed smoked sheets (RSS) No. 1 and No. 2, baled, and stored ready for the market. No mechanical equipment is used in generating the smoke in the smoke-house.

The petitioner's rollers are powered by engines although they could be turned by hand as it is done in small rubber plantations. If Pale Crepe Nos. 1 and 2 and Ribbed Smoked Sheets Nos. 1 and 2 are not air-dried and smoked, they deteriorate, get spoiled, and the color varies.

Flat Bark Rubber

Each morning before a tapper makes a fresh incision in the bark of a rubber tree, he gathers the latex drippings from the ground around the tree, called "ground rubber", as well as the dried latex from the incisions made the previous day, called "bark rubber". Ground and bark rubber are not intentionally produced. No chemicals are added to the latex transformed into ground and bark rubber. This kind of dried latex is spoiled and has a bad odor.

Ground and bark rubber when gathered in sufficient quantities are passed numerous times through the rollers or mills until they form a uniform mass or sheet which, finally is called Flat Bark Rubber. No chemical is used to coagulate the dried ground and bark rubber because they are already coagulated. They are formed into sheets by means only of pressure of the mills or rollers through which they are passed. Flat Bark Rubber commands the lowest prices in the rubber market.

3X Brown Crepe

Every morning, before a fresh incision is made in the bark of the rubber trees, the tapper collects not only ground and bark rubber but removes and collects the latex in the cups, known as "cup rubber". The cup rubber coagulates and dries through natural processes and, when gathered in sufficient quantities, is milled and rolled through a series of rollers until by force of pressure it is formed into a mass of the desired thickness called "3X Brown Crepe". Like ground and bark rubber, no chemicals are added to cup rubber to produce 3X Brown Crepe. Cup rubber in its original form, like ground and bark rubber, is spoiled and has a bad odor.

2X Brown Crepe

2X Brown Crepe is obtained by milling or rolling the excess places of coagulated rubber latex which had been cut

or trimmed from the ribbed smoked sheets No. 2 into a uniform mass. 2X Brown Crepe is produced in the same manner as the other sheets of crepe rubber, i.e., without the addition of any chemicals.

Petitioner during the said period sold its foregoing rubber products locally and as prescribed by the respondent's regulations declared same for tax purposes which respondent accordingly assessed. Petitioner paid, under protest, the corresponding sales taxes thereon claiming exemption therefrom under Section 188 (b) of the National Internal Revenue Code.

The following sales taxes on the aforementioned rubber products were paid under protest —

From Jan. 1, 1955 to Dec. 31, 1956 P83,193.48

From Jan. 1, 1957 to June 30, 1957 P20,504.99

From July 1, 1957 to Dec. 31, 1958 P52,378.90

It is further stipulated that the sales tax collected from petitioner American Rubber Company on the local sales of its rubber products, following Internal Revenue General Circulars Nos. 431 and 440, had been separately itemized and billed by petitioner Company in the invoices issued to the customers, that paid both the value of the rubber articles and the separately itemized sales tax, from January 1, 1955 to August 2, 1957.

After paying under protest, the petitioner claimed refund of the sales taxes paid by it on the ground that, under section 188, paragraph b, of the Internal Revenue Code, as amended,[1] its rubber products were agricultural products exempt from sales tax, and upon refusal of the Commissioner of Internal Revenue, brought the case on appeal to the Court of Tax Appeals (C.T.A. Nos. 356, 440, 632). The respondent Commissioner Interposed defenses, denying that petitioners products were agricultural ones within the exemption; claiming that there had been no exhaustion of administrative remedies; and argued that the sales tax having been passed to the buyers during the period that elapsed from January 1, 1955 to August 2, 1957, the petitioner did not have personality to demand, sue for and recover the aforesaid sales taxes, plus interest.

In its decision, now under appeal, the Tax Court held Preserved Latex, Flat Bark Rubber, and 3X Brown Crepe to be agricultural products, "because the labor employed in the processing thereof is agricultural labor", and, hence, the sales of such products were exempt from sales tax, but declared Pale Crepe No. 1, Ribbed Smoked Sheets Nos. 1 and 3, as well as 2X Brown Crepe (which is obtained from rolling excess pieces of Smoked Sheets) to be manufactured products, sales of which were subject to the tax. It overruled the defense of non-exhaustion of administrative remedies and upheld the Revenue Commissioner's stand that petitioner Company was not entitled to recover the sales tax that had been separately billed to its customers, and paid by the latter. Hence, it dismissed the appeal in C.T.A. Nos. 356 and 440, and ordered respondent Commissioner to refund only ₱3,916.49 without interest, or costs.

Both parties then duly appealed to this Court. The issues posed on these appeals are:

- (1) Whether the plaintiff's rubber products above described should be considered agricultural or manufactured, for purposes of their subjection to the sales tax;
- (2) Whether plaintiff is or is not entitled to recover the sales tax paid by it, but passed on to and paid by the buyers of its products; and
- (3) Whether plaintiff is or is not entitled to interest on the sales tax paid by it under protest, in case recovery thereof is allowed.

The first issue, in our opinion, is governed by the principles laid down by this Court in *Philippine Packing*

Corporation vs. Collector of Internal Revenue, 100 Phil. 545 et seq. We there ruled that the exemption from sales tax established in section 188 (b) of the Internal Revenue Tax Code in favor of sales of agricultural products, whether in their original form or not, made by the producer or owner of the land where produced is not taken away merely because the produce undergoes processing at the hand of said producer or owner for the purpose of working his product into a more convenient and valuable form suited to meet the demand of an expanded market; that the exemption was not designed in favor of the small agricultural producer, already exempted by the subsequent paragraphs of the same section 188, but that said exemption is not incompatible with large scale agricultural production that incidentally required resort to preservative processes designed to increase or prolong marketability of the product.

In the case before us, the parties have stipulated that fresh latex directly obtained from the rubber tree, which is clearly an agricultural product, becomes spoiled after only two hours. It has, therefore, a severely limited marketability. The addition of ammonia prevents its deterioration for about a month, and we see no reason why this preservative process should wrest away from the preserved latex the protective mantle of the tax exemption.

Taking also into account the great distance that separates the plaintiff's plantation from the main rubber processing centres in Japan, the United States and Europe, and the difficulty in handling products in liquid form, it can be discerned without difficulty that preserved latex, with its 30-day spoilage limit, is still severely handicapped for export and dollar earning purposes.

To overcome these shortcomings, and extend its useful life almost indefinitely, it becomes necessary to separate and solidify the rubber granules diffused in the latex, and hence, according to the stipulation of facts and the evidence, acetic acid is added to hasten coagulation. There is nothing on record to show that the acetic acid in any way produces anything that was not originally in the source, the liquid latex. The coagulum is then rolled and compacted and afterwards air dried to make Pale Crepe (1 and 2), or else cured and smoked to produce rubber sheets. Once again we see nothing in this processing to alter the agricultural nature of the result; what takes place is merely an accelerated coagulation and dessication that would naturally occur anyway, only within a longer period of time, coupled with greater spoilage of the product.

Thus the operations carried out by plaintiff appear to be purely preservative in nature, made necessary by its production of fresh rubber latex in a large scale. They are purely incidental to the latter, just as the canning of skinned and cored pineapples in syrup was held to be incidental to the large-scale cultivation of the fruit in the Philippine Packing Corporation case (ante). Being necessary to suit the product to the demands of the market, the operations in both cases should lead to same result, non-taxability of the sales of the respective agricultural products. In not so holding, the Tax Court was in error.

Even less justifiable is the position taken by the Revenue Commissioner in his appeal against the finding of the Tax Court that Flat Bark and 3X Brown Crepe rubber are agricultural products. According to the record, these sheets result from the drippings and waste rubber that have dried naturally, that are rolled and compacted into the desired thickness, without any other processing.

As to 2X Brown Crepe which is compacted out of the trimmings and waste left over from the production of ribbed smoked sheets, no reason is seen why it should be treated differently from the ribbed smoked sheets themselves.

In his appeal the Revenue Commissioner contends that all of plaintiff's products should be deemed manufactured articles, on the strength of section 194 (N) of the Revenue Code defining a "manufacturer" as

"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 manner as to prepare it for a special use or uses to which it could not have been put to in its original condition, or who x x x alters the quality of any

such raw material x x x as to reduce it to marketable shape x x x."

But, as pointed out in the Philippine Packing Corporation case, this definition is not applicable to the exemption of agricultural products, "whether in their original form or not". The use of this last phrase in the statute clearly indicates that the agricultural product may be altered in texture or form without being divested of the exemption (cas. cit. 101 Phil., p. 548). The exception would be sales of agricultural products while Republic Act No. 1612 was in effect because under this Act the freedom from sales tax became restricted to agricultural products "in their original form " only. So that plaintiff's sales from August 24, 1956 (approval of Republic Act 1612) to June 22, 1957 (when Republic Act 1856 became effective and restored the exemption to agricultural products "whether in their original form or not") became properly taxable. Under paragraphs A(2) and B(4) of the additional stipulation of facts (CTA rec. P. 261-262, G. R. L-19801), the sales tax properly collected during this period on plaintiff's transactions amounted to ₱18,187.19 from August 24 to December 31, 1956; and ₱18,888.28 from January 1 to June 21, 1957, or a total of ₱37,075.47. This last amount is, therefore, non-recoverable.[2]

The second issue in this appeal concerns the holding of the Court of Tax Appeals that the plaintiff Company is not entitled to recover the sales tax paid by it from January, 1955 to August 2, 1957, because during that period the plaintiff had separately invoiced and billed the corresponding sales tax to the buyers of its products. In so holding, the Tax Court relied on our decisions in *Medina vs. City of Baguio*, 91 Phil. 854; *Mendoza, Santos & Co. vs. Municipality of Meycawayan*, L-6069-6070, April 30, 1954 (94 Phil. 1047); and *Zosimo Rojas & Bros vs. City of Cavite*, L-10730, May 27, 1958.

The basic ruling is that of *Medina vs. City of Baguio*, supra, where this Court affirmed the ruling of the Court of First Instance to the effect that—

"The amount collected from the theater goes as additional price of admission tickets is not the property of plaintiffs or any of them. It is paid by the public. If anybody has the right to claim it, it is those who paid it. Only owners of property has the right to claim said property. The cine owners acted as mere agents of the city in collecting additional price charged in the sale of admission tickets." (*Medina vs. City of Baguio*, 91 Phil. 854) (Italics supplied)

We agree with the plaintiff-appellant that the *Medina* ruling is not applicable to the present case, since the municipal taxes therein imposed were taxes on the admission tickets sold, so that, in effect, they were levies upon the theater goers who bought them; so much so that (as the decision expressly ruled) the tax was collected by the theater owners as agents of the respective municipal treasurers. This does not obtain in the case at bar. The *Medina* ruling was merely followed in *Rojas & Bros. vs. Cavite*, supra, and in *Mendoza, Santos & Co. vs. Municipality of Meycawayan*, 94 Phil. 1047.

By contrast with the municipal taxes involved in the preceding cases, the sales tax is by law imposed directly, not on the thing sold, but on the act (sale) of the manufacturer, producer or importer (Op. of the Secretary of Justice, June 15, 1946; 47 C.J.S., p. 1141), who is exclusively made liable for its timely payment. There is no proof that the tax paid by plaintiff is the very money paid by its customers. Where the tax money paid by the plaintiff came from is really no concern of the Government, but solely a matter between the plaintiff and its customers. Anyway, once recovered, the plaintiff must hold the refunded taxes in trust for the individual purchasers who advanced payment thereof, and whose names must appear in plaintiff's records.

Moreover, the separate billing of the sales tax in appellant's invoices was a direct result of the respondent Commissioner's General Circular No. 440, providing that —

"if a manufacturer, producer, or importer, in fixing the gross selling price of an article sold by him, has included an amount intended to cover the sales tax in the gross selling price of the article, the sales tax shall be

based on the gross selling price less the amount intended to cover the tax, if the same is billed to the purchaser as a separate item in the invoice. xxx " (Italics supplied)

In other words, the separate itemization of the sales tax in the invoices was permitted to avoid the taxpayer being compelled to pay a sales tax on the tax itself. It does not seem either just or proper that a step suggested by the Internal Revenue authorities themselves to protect the taxpayer from paying a double tax should now be used to block his action to recover taxes collected without legal sanction.

Finally, a more important reason that militates against extensive and indiscriminate application of the *Medina vs. City of Baguio* ruling is that it would tend to perpetuate illegal taxation; for the individual customers to whom the tax is ultimately shifted will ordinarily not care to sue for its recovery, in view of the small amount paid by each and the high cost of litigation for the reclaiming of an illegal tax. In so far, therefore, as it favors the imposition, collection and retention of illegal taxes, and encourages a multiplicity of suits, the Tax Court's ruling under appeal violates morals and public policy.

The plaintiff Company also urges that the refund of the taxes should include interest thereon. While this Court has allowed recovery of interest in some cases, it has done so only in cases of patent arbitrariness on the part of the Revenue authorities; and in this instance we agree with the Tax Court that no such patent arbitrariness has been shown.

IN VIEW OF THE FOREGOING, the decision of the Court of Tax Appeals is affirmed in Case G. R. No. L-19667 and modified in cases G. R. Nos. L-19801, 19802 and 19803, by declaring the sales taxes therein involved to have been improperly levied and collected and ordering respondent Commissioner of Internal Revenue to refund the same, except the taxes corresponding to the period from August 24, 1956 to June 22, 1957, during which Republic Act No. 1612 was in force. The amount of P37,075.47 paid by the taxpayer for this period is hereby declared properly collected and not refundable. Without special pronouncement as to costs.

Concepcion, C.J., Barrera, Dizon, Regala, Makalintal, Bengzon, J.P., Zaldivar, and Sanchez JJ., concur.

[1] "SEC. 188. Transactions and persons not subject to percentage tax.—In computing the tax imposed in sections one hundred eighty-four, one hundred eighty-five, and one hundred eighty-six, transactions in the following commodities shall be excluded:

(a) Articles subject to tax under Title IV of this Code.

(b) Agricultural products and the ordinary salt whether in their original form or not when sold, bartered, or exchanged in this country by the producer or owner of the land where produced, as well as all kinds of fish and its byproducts when sold, bartered, or exchanged by the fisherman or fishing operator whether in their original state or not.

[2] *Collector of Internal Revenue vs. American Rubber Co.*, L-10963, April 30, 1963; *Tan Kim Tee vs. Court of Tax Appeals*, L-18080, Apr. 22, 1963.

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