

ARMANDO L. ABAD, DOING BUSINESS AS REPUBLIC ALCOHOL DISTILLERY, PETITIONER, VS. COURT OF TAX APPEALS AND COMMISSIONER OF INTERNAL REVENUE, RESPONDENTS.

G. R. Nos. L-20834 and 20903. October 19, 1966

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

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

Separate appeals by both parties from a decision of the Court of Tax Appeals, in its CTA Case No. 717, entitled "Armando L. Abad, doing business under the trade name of Republic Alcohol Distillery, petitioner, vs. Commissioner of Internal Revenue, respondent".

Briefly, the facts, as gathered from the records of this case and as stipulated by the parties, are:

Armando L. Abad is engaged in business as a distiller and operates two (2) alcohol distilleries, a bonded warehouse and bonded denaturing warehouse. During the period from January, 1955 to August, 1958, inclusive, he used the total sum of 836,483 proof liters of rectified or ethyl alcohol^{[[1]]}, without paying the specific tax thereon, in the conversion into, and for the production of, specially denatured alcohol. He produced said specially denatured alcohol, in and from his bonded denaturing warehouse, in accordance with four formulas, acquired by different grantees and duly approved by the Commissioner of Internal Revenue, and sold the same to said grantees, who, in turn, used said specially denatured alcohol as raw material in the manufacture of various non-beverage industrial products, such as varnish, pre-mixed rice, solid alcohol fuel, detergents, emulsifiers, industrial solvents, shellac, wood dye, thinner, cleansing mixtures, embalming mixtures, barbershop disinfectants like Tonix and bayrum. These products contain more than 50% ethyl alcohol by volume, excluding water.

During the same period of January, 1955 to August, 1958, Abad also produced and sold completely denatured alcohol of not less than 180 degrees proof (ninety per cent absolute alcohol) for which he paid the 7% sales tax on the gross sales; but in the computation of the sales tax, he deducted the cost of ethyl alcohol purchased from suppliers and used in the manufacture of said completely denatured alcohol, although the distillers and sellers of said ethyl alcohol did not pay any specific tax nor did they declare their sales for purposes of the sales tax imposed by Section 186 of the Tax Code.

On December 12, 1958, the Commissioner of Internal Revenue wrote a letter to Abad, assessing and demanding the following: (a) As specific tax on the rectified or ethyl alcohol used in the production of specially denatured alcohol, computed as follows:

Year

Proof Liter

Rate

Specific Tax

1955.....

400,592

P0.70

P280,414.40

1956.....

330,051

"

231,035.70

1957.....

47,004

"

32,902.80

Jan. to Aug. 1958.....

58,836

0.45

26,476.20

TOTAL.....

836,438

P570,829.10

(b) As deficiency sales tax and surcharge on the gross selling price of completely denatured alcohol, computed as follows:

Year

Gross Sales

Deductions

Taxable Sales

1955.....

P193,303.75

P32,071.57

P161,237.18

1956.....

499,623.50

90,938.28

408,685.22

1957.....

1,565,714.83

151,082.31

1,414,632.32

Jan. to Aug. 1958.....

1,664,725.21

131,462.58

1,533,262.63

TOTAL.....

P3,923,372.29

P405,554.74

P3,515,817.35

7% sales tax due on P3,517,817.35

P 246,247 .21

LESS: Sales tax already paid.....

79,934.97

Deficiency Sales Tax.....

P 166,312.24

25% surcharge.....

41,578.06

TOTAL

P207,890.30

(c) P300.00 as compromise penalty for the loss of his books of accounts and records.

In due time, after receipt of the above stated assessment and demand letter, Abad contested it; and the case was elevated to the Appellate Division of the Bureau of Internal Revenue. After due hearing therein, the Commissioner of Internal Revenue, in a letter dated October 27, 1959, reiterated his previous assessment; hence, Abad filed his petition for review in the Court of Tax Appeals, disputing the validity of the assessment.

After the filing of the usual answer by the Commissioner of Internal Revenue, the parties submitted the case for decision on a stipulation of facts.

On the basis of this stipulation, the Tax Court rendered its decision, dated January 4, 1963, ruling that it having been admitted that the 836,483 proof liters of specially denatured alcohol[2] consist of 50% ethyl alcohol by volume, excluding water, distilled spirits compose its chief ingredient; hence, it is subject to specific tax pursuant to Section 127, in relation to Section 133, both of the Tax Code; that it also having been admitted that said specially denatured alcohol was used as raw materials in the manufacture of other products by the different

grantees thereof and not used in the operation of industries, it is not exempt from specific tax under Section 128 of the same Code; and that it having been admitted further that Abad himself sold and removed said alcohol, he should be held liable for said specific tax, and not the grantees or buyers thereof. The same decision, however, held petitioner Abad not liable for deficiency sales tax and surcharge, ruling that when ethyl alcohol is sold for use in the production of completely denatured alcohol it ceases to be liable for the specific tax imposed by Section 133 of the Tax Code, and, not being included among the articles taxable under sections 184 and 185 of the same Code, the sales of said ethyl alcohol become subject to sales tax under section 186; hence, for purposes of computing the sales tax due on the sales of completely denatured alcohol pursuant to same section 186, the total cost of said ethyl alcohol is deductible from the gross selling price thereof, regardless of whether the specific or sales taxes thereon had previously been paid or not. Said decision also held Abad not liable for the P300.00 compromise penalty for the loss of his books of accounts and records, it having been admitted by respondent Commissioner that the same can not be imposed without the consent of the taxpayer, and Abad did not give his consent thereto.

Petitioner Armando L. Abad, not satisfied with that portion of the decision of the Tax Court holding him liable for specific tax on the specially denatured alcohol, interposed his appeal to this Court, which was docketed as G. R. No. L-20834; while respondent Commissioner of Internal Revenue filed his separate appeal (which was docketed as G. R. No. L-20903) against that part of the decision holding Abad not liable for deficiency tax and surcharge.

We will first consider Abad's appeal (G. R. No. L-20834). In this connection, it is unnecessary to decide whether or not specially denatured alcohol is subject to specific tax, an issue which is immaterial and irrelevant to the controversy.

The reason is that the specific tax was assessed on the 836,483 proof liters of rectified or ethyl alcohol used in the production or manufacture of specially denatured alcohol and not on the specially denatured alcohol itself. This is evident from respondent Commissioner's letter dated December 22, 1958, and subsequent letter dated October 27, 1959, as pointed out in the appealed decision (C.T.A. record, p. 173). The pertinent portion of each letter is quoted below, for ready reference:

"It was also found that you failed to pay the specific tax due on the rectified alcohol used in denaturing before removal from your distillery premises, in violation of section 124, in relation to sections 127 and 128, all of the National Internal Revenue Code." (C.T.A. record, p. 6; BIR record, pp. 1-2, Annex A, Abad's petition for review) (Emphasis supplied)

"It may be stated by way of explanation that the specific tax was assessed on the distilled spirits which were used in the production of denatured alcohol in the Republic Alcohol Distillery denaturing plant at 270 F. Roxas, Grace Park, Caloocan, Rizal, x x x x x." (Annex "C", Abad's petition for review; CTA record, p. 58; BIR record, p. 108; underlining supplied for emphasis)

Hence, the real issue involved herein is whether or not the 836,483 proof liters of rectified or ethyl alcohol used in the production or manufacture of specially denatured alcohol is subject to specific tax, and to what extent petitioner Abad is liable for the payment of such tax.

During the period of time covered by the assessment of specific tax on the rectified or ethyl alcohol in question, i.e., from January, 1955 to August, 1958, the provisions of the Tax Code governing specific taxes on rectified or ethyl alcohol are Sections 124, 127 and 133 of said Tax Code, as amended, to wit:

"SEC. 124. Payment of specific tax on domestic products. - Specific tax on domestic products shall be paid by the manufacturer, producer, owner, or person having possession of the same; and, except as otherwise specially allowed, such taxes shall be paid immediately before removal from the place of production." (National Internal

Revenue Code)

"SEC. 127. Tax on preparations containing distilled spirits as chief ingredient. - Medicinal preparations, flavoring extracts, and all other preparations, except toilet preparations, of which excluding water, distilled spirits form the chief ingredient, shall be subject to the same tax as such chief ingredient." x x x x x x x x x x x x x x x x x x x

"SEC. 133. Specific tax on distilled spirits. - On distilled spirits there shall be collected subject to the provision 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 juice, syrup, sugar of the cane, per proof liter, seventy centavos; x x x x x x x x x x x x x x x x x x x

'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 and 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." [3] (Emphasis supplied)

x x x x x . (National Internal Revenue Code, as amended).

From Section 133 of the Tax Code, it cannot be disputed that rectified or ethyl alcohol falls within the definition or enumeration of the term "distilled spirits", and is taxable as such. But during the period that transpired between the enactment of Republic Act No. 592 (effective January 1, 1951) and the enactment of Republic Act No. 1608 (in force from August 23, 1956 onward) the specific tax did not attach to the alcohol upon its coming into existence; hence, this Court has ruled that a producer of ethyl alcohol specially denatured and sold to permittees of the Collector of Internal Revenue is not liable for the tax, but that said tax is to be paid by the producer of the taxable finished product (Commissioner of Internal Revenue vs. Central Azucarera Don Pedro, L-14015, May 31, 1960; La Tondeña, Inc. vs. Collector of Internal Revenue, G. R. L-14336, April 30, 1964). In the La Tondeña case, this Court expressly ruled that:

"Judgment. - This appellant is liable; but we agree that its liability attached not upon its manufactured ethyl alcohol but upon its medicinal product - the rubbing alcohol.

"Accordingly, in the instant case, above petitioner (La Tondeña) shall pay only the specific tax corresponding to the quantity of rubbing alcohol it marketed or only on 35,298 proof liters. Needless to add, the appellant is not responsible for taxes on the alcohol it sold to permittees of the Internal Revenue Office." (Emphasis supplied)

The Tax Court sought to differentiate the case of Central Azucarera Don Pedro from that of herein petitioner Abad by pointing out that, in the former, the specially denatured alcohol "was removed by the buyers, while in the present case, the removal was made by the petitioner himself" . We find this alleged difference to be unsubstantial, because the parties expressly stipulated that Abad's alcohol was manufactured and denatured "for the uses applied for by the grantees thereof, and duly approved by the respondent commissioner" (Stip. p. 4). Since the alcohol was produced and denatured for the particular use of the grantees or permittees to whom it was sold, and conformably to their requirements, the removal of the alcohol was done by Abad only as an agent of the buyers for whom the alcohol was destined from the start. Removal by Abad, therefore, was in law removal by the buyers, and the Central Don Pedro and the La Tondeña rulings by this Court are fully applicable.

During the period from January, 1955 to August 22, 1956, when Republic Act 1608 became effective, the record discloses that Abad used for denaturation and sale the following quantities of rectified or ethyl alcohol, computed

as follows:

Year

Proof Liter

Rate

Specific Tax Assessed

1955.....

400,592

P0.70

P280,414.40

Jan. to Aug. 22, 1956.....

256,141

0.70

179,298.70

TOTAL.....

656,733

P459,713.10

Following our rulings aforesaid, this last amount should be deducted from appellant Abad's tax liability, having been improperly assessed against him.

Upon the other hand, when Republic Act No. 1608 reincorporated to Section 133 of the Tax Code the underlined proviso (ante, p. 7), it is evident that distilled spirits, such as rectified or ethyl alcohol, produced or manufactured after August 23, 1956 became subject to specific tax as soon as it came into existence as such; and that the manufacturer, producer, owner, or person having possession of the same at the time is liable for said specific tax (Sec. 124, National Internal Revenue Code).

It appears that after August 22, 1956, petitioner Armando L. Abad was the owner or producer of quantities of rectified or ethyl alcohol, computed as follows:

Year

Proof Liter

Rate

Specific Tax Due

Aug. 23 to Dec. 31, 1956.....

73,910

P0.70

P51,737.00

1957.....

47,004

0.70

32,902.80

Jan. to Aug. 1958

58,836

0.45

26,476.20

TOTAL.....

179,750

P111,116.00

And it being undisputed that said rectified or ethyl alcohol is distilled spirits if within the meaning of Section 133 of the Tax Code [4], and that by Republic Act No. 1608 the specific tax attaches to this substance as soon as it is in existence as such; then petitioner Armando L. Abad should be required to pay the above computed tax of P111,116.00 assessed on the 179,750 proof liters of rectified or ethyl alcohol produced by him from August 23, 1956 to August of 1958.

However, appellant Abad claims exemption from specific tax on the theory that the mixing of denatured alcohol with other materials, resulting into rubbing alcohol, varnish, bayrum, lacquer, etc., constitutes use in arts in industries, that is, frees the alcohol from Tax under Section 128 of the Tax Code:

"SEC. 128 - Exemption in favor of domestic denatured alcohol. - Domestic alcohol of not less than one hundred eighty degrees proof (ninety percentum absolute alcohol) may, when denatured, be withdrawn from a registered distillery or bonded warehouse without the prepayment of the specific tax prescribed in section 133,

for the purpose of being used for fuel, or light, or for use generally in the arts, industries, hospitals sanitaria, and clinics or for research or experimental purposes, or for the official use of the Government of the Republic of the Philippines or its instrumentalities or political subdivisions. (As amended by Republic Act No. 1608, approved August 23, 1956)"

We agree with the Tax Court that this claim of appellant is untenable. Under the facts, as stipulated, what is used or is marketed for use in arts and industries is not the denatured alcohol (as required by Section 128), since it loses its identity upon mixture or combination with other materials; what comes into use is the resultant product, which is different from the denatured alcohol itself.

The argument that a narrow interpretation of the exemption has favored imported isopropyl alcohol is a consideration that should be addressed to the Legislature and not to the courts that are not authorized to view laws from the standpoint of their results. It is well settled that tax exemptions, as exceptions to the general rule, are not favored, and can not be presumed nor created by implication (*Collector vs. Manila Jockey Club*, 98 Phil. 670, 676; *Song Kiat Chocolate Factory vs. Central Bank*, 54 Off. Gaz. 615).

Lastly, the claim that the tax on distilled spirits is collectible only on spirits fit for consumption has been also rejected by our decision in *La Tondeña vs. Collector of Internal Revenue*, G.R. No. L-14336, April 30, 1964.

Coming now to the appeal of the Commissioner of Internal Revenue (G. R. L-20903): the only issue therein posed is whether or not the cost of ethyl alcohol purchased from other distilleries and used in the manufacture of completely denatured alcohol by petitioner Abad is deductible from the gross selling price of said completely denatured alcohol in computing the 7% sales tax imposed by Section 186 of the National Internal Revenue Code. In deciding this point, the lower court opined that it was so deductible.

Respondent Commissioner assails the conclusion of the lower court, contending that under Section 164 of the Tax Code the purpose of the requirement of posting a bond before ethyl alcohol is withdrawn or removed for denaturing for use as fuel, light, and other purposes enumerated in Section 128 of the same Code is to free the distiller or producer thereof from paying any internal revenue tax, whether specific tax or percentage sales tax; that the sale of said ethyl alcohol is not subject to sales tax under Section 186 nor under Section 189 of the same Code, it not being one of the articles taxable under the latter section; and this coupled with the admitted fact that the distiller or producer of said ethyl alcohol did not declare their sales, nor paid the sales tax thereon (citing the *Tan Chiu* case), petitioner Abad is precluded from deducting the cost of said ethyl alcohol from the gross selling price of the completely denatured alcohol, for purposes of computing the 7% sales tax imposed by Section 186 of the Tax Code.

If the completely denatured alcohol is free from specific tax, yet the ethyl alcohol from which it is made, though not listed as subject to sales tax under Sections 184, 185 and 185-A of the Tax Code, becomes subject to sales tax under the first part of Section 186, and its cost is deductible in the computation of the sales tax under the last part or proviso of the same section. It will be noted that the terms of Section 186 (first portion) are sufficiently broad to cover sales of such ethyl alcohol:

"SEC. 186. Percentage tax on sales of other articles - There shall be levied, assessed and collected once only on every original sale, barter, exchange, and similar transaction either for nominal or valuable considerations, intended to transfer ownership of, or title to, the articles not enumerated in sections one hundred and eighty-four and one hundred and eighty-five a tax equivalent to seven per centum of the gross selling price or gross value in money of the articles so sold, bartered, exchanged, or transferred, such tax to be paid by the manufacturer or producer: Provided, That where the articles subject to tax under this section are manufactured out of materials likewise subject to tax under this section and one hundred and eighty-nine the total cost of such materials, as duly established, shall be deductible from the gross selling price or gross value in money of

such manufactured articles." (first paragraph, National Internal Revenue Code, as amended)

The Tax Court, therefore, correctly held that the sales of said ethyl alcohol to Abad are subject to sales tax under the first part of Section 186, already quoted; wherefore, the cost thereof is deductible from Abad's gross selling price of the completely denatured alcohol made from it, for purposes of computing the 7% sales tax due on the latter.

The same result obtains when it is considered that, under Section 188(a) of the Tax Code, transactions in commodities subject to taxes under Title IV of the Code (specific taxes) are to be excluded in computing the sales tax under Sections 184 to 186. Since the alcohol was purchased by Abad before it was denatured, it was then subject to specific tax, and its cost should be deducted from the computation of the sales tax due on the sale of the denatured alcohol.

The fact that Abad's suppliers of ethyl alcohol did not pay sales tax thereon is no reason for burdening Abad with said tax.

The Commissioner's contention that the bond required under Section 164 is answerable for all kinds of internal revenue taxes is too far-fetched and not tenable because the evident purpose of said bond is to make it answerable only for specific taxes in the event that the producer of the denatured alcohol will not use the distilled spirits for the purpose or the uses described in Section 128 (light, fuel, etc.), when it is allowed to be withdrawn under bond.

"SEC. 128. Exemption in favor of domestic denatured alcohol - Domestic alcohol of not less than one hundred eighty degrees proof (ninety per centum absolute alcohol) may, when denatured, be withdrawn from a registered distillery or bonded warehouse without the prepayment of the specific tax prescribed in section 133, for the purpose of being used for fuel, or light, or for use generally in the arts, industries, hospitals, sanitarium, and clinics, or for research or experimental purposes, or for the official use of the Government of the Republic of the Philippines or its instrumentalities or political subdivisions.(As amended by Republic Act No. 1608, approved Aug. 23, 1956)."

"SEC. 164. Requirements incident to process of denaturing alcohol. - Where alcohol is withdrawn for denaturing for purposes enumerated in section 128* of this Tax Code, or a motor fuel, the process of denaturing shall be effected either on the distillery premises or in a bonded warehouse designated by the Commissioner of Internal Revenue for denaturing purposes only. To such warehouses, alcohol may be transferred under bond under conditions prescribed in the regulations of the Department of Finance. (As amended by Republic Act No. 1608, approved Aug. 23, 1956)"

The Tan Chiu case, G. R. No. L-15008, January 28, 1961, relied upon by the Commissioner of Internal Revenue is not applicable to the case at bar, the ruling in that case being that the cost of the raw materials was not allowed to be deducted from the gross selling price of the finished product, not because there was non-payment of the sales tax, but because the raw materials there were expressly exempted from taxes as used by new and necessary industries (Rep. Act No. 901), and no sales tax was naturally expected to be paid thereon.

WHEREFORE, the decision of the Court of Tax Appeals is modified, as follows:

In G. R. No. L-20834, petitioner-appellant Armando L. Abad, doing business under the trade name of Republic Alcohol Distillery, is ordered to pay only the amount of P111,116.00 as specific tax on 179,750 proof liters of rectified or ethyl alcohol.

In G. R. No. L-10903, that part of the same decision of the Tax Court appealed by respondent-appellant Commissioner of Internal Revenue should be, as it is hereby, affirmed. Without costs in either appeal.

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

Barrera, J., on leave.

[1] As appearing in the records, the Commissioner of Internal Revenue or his subordinates interchanged loosely in using the terms "rectified" or "ethyl" alcohol.

[2] Should have been rectified or ethyl alcohol, as will be shown hereafter.

[3] The underlined phrase was deleted by Republic Act No. 592, effective January 1, 1951, but was reinserted by Republic Act No. 1608, effective August 23, 1956; See Collector of Internal Revenue vs. La Tondeña, Inc., G. R. No. L-10431, July 31, 1962.

[4] Collector vs. La Tondeña, G.R. No. L-10431, July 31, 1962; La Tondeña vs. Collector, G.R. No. L-14336, April 30, 1964.

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