

THE COMMISSIONER OF INTERNAL REVENUE, PETITIONER AND APPELLANT, VS. P.J. KIENER COMPANY, LTD., INTERNATIONAL CONSTRUCTION CORPORATION, GAVINO T. UNCHUAN AND THE COURT OF TAX APP...

G.R. No. L-24754. July 18, 1975

Ponente: MARTIN, J.

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MARTIN, J.:

This is a case that draws Us to the tax exemption provision written in the Military Bases Agreement[1] celebrated by the Republic of the Philippines and the United States of America on March 14, 1947, and pursued in the "Aide Memoire"[2] between the two Governments on April 27, 1955.

A quo a decision was rendered by respondent Court of Tax Appeals ordering the Commissioner of Internal Revenue "to give tax credit to [private respondents] the amount of P18,272.21, without pronouncement as to costs." The Tax Court modified the ruling of the Commissioner of Internal Revenue denying the request of the private respondents for tax credit amounting to P21,478.31, the total of specific taxes supposedly paid by them. Petitioner seeks a review of said judgment.

Respondent P.J. Kiener Company, Ltd. is a domestic limited co-partnership, doing business in the Philippines, while respondent International Construction Corporation is a domestic corporation duly organized and existing under and by virtue of the laws of the Philippines, likewise engaged in business in the Philippines.[3] On or about December 14, 1957, respondent companies entered into a joint venture with respondent Gavino T. Unchuan, a licensed Filipino civil engineer, to bid, for the construction of the Mactan Airfield in Mactan Island, Municipality of Opon (now Lapu-lapu City), Cebu. Respondents won the bid. And so, on February 19, 1958, the Republic of the Philippines, represented by Lt. Gen. Alfonso Arellano, then Chief of Staff, Armed Forces of the Philippines, entered into a contract with private respondents, Article I of which provides, inter alia, ". . . That the . . . general conditions . . . are hereby made integral parts of this contract by incorporation and reference respectively." Of these "General Conditions", Section 3-19 provides:

"3-19 Taxes — In accordance with the Mutual Defense Agreement between the United States of America and the Republic of the Philippines, no tax of any kind or description will be levied on any material, equipment or supplies which may be purchased or otherwise acquired in connection with the project under contract, which material, equipment or supplies are required solely for such project." (*Italics supplied*)

This is the root of the controversy.

Towards the middle of 1958, private respondents commenced construction of the Mactan Airfield and started purchasing "petroleum products to run and maintain their machineries and equipment" from Caltex (Phil.) Inc.[4] During the period of February 1, 1960 through April 11, 1960, they likewise purchased motor gasoline, kerosene, lubricating and/or motor oil, and diesel fuel from Caltex (Phil.) Inc. For these petroleum products, Caltex (Phil) Inc. paid the Bureau of Internal Revenue P21,478.31 of specific taxes. This amount was, in turn, included in the

prices of the petroleum products paid by private respondents to Caltex (Phil.) Inc.[5]

On 29 December 1960, private respondents wrote petitioner, requesting it to refund to Caltex (Phil.) Inc. the amount of P21,478.31.[6] Caltex (Phil.) Inc. followed the request with a formal claim for tax credit on January 12, 1961. Since no answer was forthcoming, private respondents instituted on January 31, 1962, a petition for review with the respondent Court of Tax Appeals. They prayed that they be credited the amounts of P21,478.31 and P151.65, specific and sales taxes, respectively, plus interest at the legal rate from that date until the grant of the tax credit.[7] However, before the trial of the case, the sales tax of P151.65 was credited in favor of Caltex (Phil.) Inc.[8]

Subsequently, or on 7 January 1963, petitioner formally denied the request of Caltex (Phil.) Inc. stating that as per the ruling of the Department of Finance in its answer to the query of the Philippine Electrical Supply, dated July 18, 1962:

"Oils used by contractors in the operation of their machines or other equipment in pursuance of their contract are not materials to be used solely for the aforesaid military projects but petroleum products to be used in the operation of contractor's machines or equipment. Consequently, the same cannot be exempted from local taxes as well as customs duties and special import tax."

After trial, the Tax Court rendered the judgment appealed from. It deducted from the P21,478.31 claimed for the specific tax of P908.40 (petroleum products used in the demolition of the Opon Church in Mactan) and the specific tax of P2,297.74 paid on January 15, and 25, 1960 for being barred by prescription (claim for refund was filed only on January 31, 1962).[9]

Petitioner delimits its issue or question to the dispositive portion of the Tax Court decision ordering petitioner "to give tax credit to [private respondents] in the amount of P18,272.21**"[10] and assigns that the Tax Court erred —

I

"... IN HOLDING THAT UNDER THE MUTUAL DEFENSE AGREEMENT BETWEEN THE UNITED STATES OF AMERICA AND THE REPUBLIC OF THE PHILIPPINES THE PETROLEUM PRODUCTS IN QUESTION ARE EXEMPT FROM THE PAYMENT OF THE SPECIFIC TAX.

II

". . . IN HOLDING THAT UNDER THE 'AIDE MEMOIRE' OF APRIL 27, 1955, BETWEEN THE PHILIPPINE REPUBLIC AND THE UNITED STATES OF AMERICA, THE PETROLEUM PRODUCTS IN QUESTION ARE EXEMPT FROM THE PAYMENT OF SPECIFIC TAX.

III

". . . IN HOLDING THAT THE PETROLEUM PRODUCTS IN QUESTION COME WITHIN THE PURVIEW OF THE WORDS 'MATERIAL' OR 'SUPPLIES' MENTIONED IN THE 'AIDE MEMOIRE' OF APRIL 27, 1955, BETWEEN THE PHILIPPINE REPUBLIC AND THE UNITED STATES OF AMERICA, AND OF SECTION 3-19 OF THE GENERAL CONDITIONS ATTACHED TO THE SPECIFICATION FOR MACTAN AIRFIELD WHICH WAS MADE AN INTEGRAL PART OF THE CONTRACT BETWEEN THE PHILIPPINE GOVERNMENT AND THE RESPONDENTS P.J. KIENER COMPANY, LTD., INTERNATIONAL CONSTRUCTION CORPORATION AND GAVINO T. UNCHUAN.

IV

". . . IN HOLDING THAT THE RESPONDENTS P.J. KIENER COMPANY LTD., INTERNATIONAL CONSTRUCTION CORPORATION AND GAVINO T. UNCHUAN ARE ENTITLED TO CLAIM FOR TAX CREDIT OF THE SPECIFIC TAXES WHICH THEY ALLEGEDLY PAID ON THE PETROLEUM PRODUCTS IN QUESTION; AND

V

". . . IN ORDERING THE HEREIN PETITIONER TO GIVE TAX CREDITS TO THE RESPONDENTS IN THE AMOUNT OF P18,272.21.

The matrix of these imputations, however, is whether the petroleum products in question are "materials" or "supplies" purchased or otherwise acquired "in connection with" the construction of the Mactan Airfield and which "materials" or "supplies" are required "solely" for such project.

Private respondents flawlessly narrate that when they began construction towards the middle of 1958, they started purchasing the petroleum products from Caltex (Phil.) Inc. "to run and maintain their machineries and equipment used in the construction." The "equipment" refers to fuel pumping machineries, radar facilities, and the like. Purchase went through April 11, 1960, when months thereafter the conflict on the tax credit arose. Private respondents would deliver the conclusion that these petroleum products are tax-exempt since they have been ". . . purchased or otherwise acquired in connection with the project . . ." The fact that they are not incorporated into the Mactan Airbase would not defeat the exemption.[11]

The sense which private respondents proffer to attach to the terms "materials" and "supplies" eludes the link welded into the Military Bases Agreement and "Aide Memoire" and recognized in Section 3-19 of the "General Conditions". The Military Bases Agreement states that "No import, excise, consumption or other tax . . . shall be charged on material, equipment, supplies or goods, . . . for exclusive use in the construction . . . of the bases . . ." (Art. V, footnote 1). The "Aide Memoire" provides: ". . . no internal taxes of any kind or description, except income taxes, shall be levied on any materials, equipment, supplies and/or services which may be purchased or otherwise acquired in connection with the [construction of the Mactan Airfield] . . ." (Sec. 6, Footnote 2). Section 13-9 of the "General Condition" stipulates that ". . . no tax of any kind or description will be levied on any material, equipment or supplies which may be purchased or otherwise acquired in connection with the project . . ." Reduced into simple terms, the underscored phrases continuously used in the two treaties and in the contract could only mean, collectively, "construction" materials or supplies which must necessarily be incorporated in the construction of the airfield. For the terms "materials" and "supplies" refer to something "going into or consumed" in the performance of the work[12] such as mortar, cement, sand, bricks, lumber[13] or nails, glass, hardware, and a thousand other things that might be meant, which are necessary to the completed erection of a building or structure.[14] Thus examined, the petroleum products purchased by the private respondents "to run and maintain their machineries and equipment" cannot be categorized as "materials" or "supplies" since they do not go into or are consumed in the construction, but in the machineries and equipment.

Nonetheless, private respondents would unwrap a thesis that if Section 13-9 of the "General Conditions" intended to refer only to "materials" or "supplies" which form part and/or incorporated into the project, the said section would have so stated, just like when it provided that "Only equipment which will be incorporated in the construction" are tax free[15] They would thus seize the absence of such proviso as a recognition of the tax-exemption of those "materials" or "supplies" not necessarily incorporated in the construction. The argument misses the point. In its textual completeness, Section 13-9 provides: "Only equipment which will be incorporated

in the construction can be imported tax free on certification of the Engineer." (Last sentence, 2nd par.) It deals centrally on the importation of equipment. The Government had conceded the privilege of exemption to this item because the same may not be "economically procurable in terms of price and quality within the Philippines." (Sec. 2, "Aide Memoire"). To assure, however, that the privilege is not abused or circumvented, the Government has stipulated in Section 13-9 of the "General Conditions" that the equipment [must] be incorporated in the construction . . . " It was intended by the Government as an open restraint against possible detour of the revenue and customs laws. The reason is easily discernible. There still pervaded even at that time the sentiment of preference to local products, as can be plucked from the ultimate sentence of Section 2, "Aide Memoire", thus:

"Locally produced materials, however, shall be used wherever such materials are of satisfactory quality and are available at reasonable, comparable prices."

Under these circumstances, the contractual proviso in Section 13-9 (supra) cannot be isolated and stretched to mean that "materials" and "supplies" need not be incorporated in the construction to be tax-exempt. It is essentially non sequitur.

Private respondents would, however, seek a final refuge in the Commissioner of Customs vs. Caltex (Phil.) Inc., No. L-13067, December 29, 1959 ruling that "gasoline and oil furnished [Caltex] drivers during the construction job come within the import of the 'material or supplies'". In that case, Caltex (Phil.) Inc. was granted by the Secretary of Agriculture and Natural Resources a petroleum refining concession with the right to establish and operate a petroleum refinery in the municipalities of Bauan and Batangas, province of Batangas. The concession made the provisions of Republic Act No. 387[16] as an integral part. In its operation, Caltex (Phil.) Inc. used as basic material crude oil imported from abroad. Customs duties were imposed on this imported crude oil and so, Caltex sought for refund. The Court of Tax Appeals ordered a refund. On petition for review, the Supreme Court held that under Article 103 of the Act[17] the petroleum products imported by respondent Caltex (Phil.) Inc. for its use during the construction of the refinery are exempt from the customs duties and that gasoline and oil furnished its drivers during the construction job come within the import of the words "material" or "supplies".

It bears emphasis, however, that the words "material" or "supplies" in that ruling were interpreted in relation to the provisions of the Act, particularly Article 103. Unlike the treaties and contract in the case at bar, no express provision[18] is therein contained that the "materials" or "supplies" must be "for exclusive use in the construction" (Art. V, Military Bases Agreement) or "in connection with the [construction] ... which materials ... supplies are required solely for such projects." (Cf. Sec. 6, "Aide Memoire" and Sec. 13-9 of "General Conditions"). It is understandable why. At that time there was no Philippine crude petroleum available for the use of any refinery in the Philippines, and so imported crude petroleum was allowed so as not to defeat the objective of the Act which was to promote and encourage the exploration, development, production and utilization of the petroleum resources of the Philippines. Thus far, the importation of these "materials" and "supplies" was only circumscribed by a liberal proviso that the exemption shall not be allowed on "goods imported by the concessionaire for his personal use or that of any others." [19] Beyond that, the exemption operates. As far as the "materials" and "supplies" are concerned, they need not be incorporated into the construction to fall within the province of the exemption.

The present case is situated on a different plane. Explicitly, the "materials" and "supplies" must be for exclusive use in, in connection with, and required solely for the construction of the Mactan Airfield. In short, the "materials" and "supplies" need be incorporated in the construction for the exemption to apply. It, therefore, results that the Caltex ruling cannot be invoked as it is to be interpreted within the context of Republic Act 387.

Anent this, the Secretary of Finance in its letter of July 18, 1962 to the Philippine Electrical Supply Co., Inc. ruled

that "Oils used by contractors in the operation of their machines or other equipment ... are not materials to be used solely for . . . military projects but petroleum products to be used in the operation of the contractor's machines or equipment." [20] They are, consequently, not tax-exempt. The ruling commands much respect and weight, since it proceeds from the official of the government called upon to execute or implement administrative laws [21] and it lays down a sound rule on the matter. [22]

Nor could the ambiguity that thus sprang from the tax-exemption provision in the Military Bases Agreement and in the "Aide Memoire" in accordance with which [23] the contract in question was entered into be interpreted in favor of the American Government or, for that matter, any party claiming under it, like private respondents. [24] Lauterpacht says that "if two meanings of a stipulation are admissible, that which is least to the advantage of the party for whose benefit the stipulation was inserted in the treaty should be preferred." [25] Especially when it is considered that for the Philippine Government, "the exception contained in the tax statutes must be strictly construed against the one claiming the exemption" [26] because the law "does not look with favor on tax exemptions and that he who would seek to be thus privileged must justify it by words too plain to be mistaken and too categorical to be misinterpreted." [27]

An error has been assigned by petitioner that while the petroleum products were all purchased by private respondents from the Caltex (Phil.) Inc., for which the latter paid the specific taxes and sales taxes, private respondents did not come up with proofs that the specific taxes of P21,478.31 were included in the purchase price paid by them, and that the phrase "Statement of Specific Tax Excluded from Sales to P.J. Kiener Co. Ltd." appearing in both Exhibits A and B of private respondents means that the purchase price did not include said taxes. [28] The Court of Tax Appeals, however, found that the tax of P21,478.31 has been shifted by Caltex (Phil.) Inc. to private respondents. [29] This finding of the Tax Court must be accorded deference, "being well-nigh conclusive" upon the Supreme Court. [30]

IN VIEW OF THE FOREGOING, the judgment of the Court of Tax Appeals ordering petitioner "to give tax credit to [private respondents] the amount of P18,272.21" is reversed and set aside. In all other respects the judgment appealed from is affirmed. Without pronouncement as to costs.

SO ORDERED.

Castro, Makasiar and Muñoz Palma, JJ., concur.

Esguerra, J., concurs in the result.

Teehankee, J., on leave.

[1] Art. V. Exemption from Customs and Other Duties. No import, excise, consumption or other tax, duty or impost shall be charged on material, equipment, supplies or goods, including food stores and clothing, for exclusive use in the construction, maintenance, operation or defense of the bases, consigned to, or destined for, the United States authorities and certified by them to be for such purposes.

[2] Sec. 6. The Government of the Republic of the Philippines shall permit the unrestricted entry, and shall exempt from all duties and all taxes, such products, property, materials, services and/or equipment as required to be imported for the construction of military facilities pursuant to this Agreement, whether such importation is effected either directly by the Philippine Government and/or the Government of the United States or indirectly by private persons or firms under contract with the Philippine Government for construction of said military facilities. The Philippine Government agrees that no internal taxes of any kind or description, except income taxes, shall be

levied on any materials, equipment, supplies and/or services which may be purchased or otherwise acquired in connection with the terms of this Agreement on an approved project as referred to herein, which materials, equipment, supplies and/or services are required solely for such projects.

[3] CTA Records, at p. 1

[4] Brief, Respondents-Appellees, at p. 5.

[5] CTA Records, at p. 3.

[6] Brief, Petitions, at p. 3

[7] *Idem.*, at p. 4.

[8] *Idem.*, at p. 4.

[9] See *Commissioner of Internal Revenue vs. Victorias Milling Inc.*, L-24108, January 3, 1968, 22 SCRA 12.

[10] Brief, Petitioner, at p. 5.

[11] Brief, Respondents-Appellees, at p. 17.

[12] 26-A Words and Phrases, Perm. ed., 316, citing *People's Nat. Bank vs. Southern Surety Co.*, 288 P. 827, 828, 105 Cal. App. 731; see also *Bouvier's Law Dictionary*, p. 2121, defining "materials" as "matter which is intended to be used in the creation of a mechanical structure."

[13] 26-A Words and Phrases, Perm. ed. 299, citing *Johns-Manville Corporation, vs. La Tour D' Argent Corporation*, 277 Ill. App. 502; *Travelers' Ins. Co. vs Village of Ilion*, 213 N.Y.S. 206, 207, 126 Misc. 275.

[14] *Tsutakawa vs. Kumamoto*, 101 P. 869, 53 Wash, 231; *Armour & Co. vs. Western Construction Co.*, 78 P.1106, 1107; 36 Wash, 529, cited in 26-A Words and Phrases, Perm. ed., p. 300.

[15] Brief, Respondents-Appellees, at p. 15.

[16] An Act to Promote the Exploitation, Development Exploitation, and Utilization of the Petroleum Resources of the Philippines; to Encourage the Conservation of such Petroleum Resources; to Authorize the Secretary of Agriculture and Natural Resources to Create an Administration Unit and a Technical Board in the Bureau of Mines; to appropriate Funds therefor; and for other purposes, signed into law on June 18, 1949.

[17] Art. 103. Customs duties. — During the first five years following the granting of any concession, the concessionaire may import free of customs duty, all equipment, machinery, material, instruments, supplies and accessories. No exemption shall be allowed on goods imported by the concessionaire for his personal use or that of any others; nor for sale or for re-export; and if any goods on which exemption has been allowed be thus used or disposed of, the concessionaire is obliged to make a report to the Secretary of Agriculture and Natural Resources to that effect and to pay such import duty as is due.

[18] See Footnote 17.

[19] *Idem.*

[20] At p. 5, this Decision. It reversed its previous ruling of July 11, 1958 that the said petroleum products may be supplied tax-free (CTA. Records, at p. 52).

[21] *Tan vs. Municipality of Pagbilao, Quezon*, L-14264, April 30, 1963, 7 SCRA 887.

[22] *Sarmiento, et al. vs. Nolasco, et al.*, L-38565, November 15, 1974, First Division, per Esguerra, J., 61 SCRA

81.

[23] At p. 3, this Decision.

[24] The Mactan Airbase is listed in Annex "B" of the Military Bases Agreement as one of the bases granted to the United States under Art. 1 thereof. Its construction was financed by the American Government. As earlier pointed out, the construction was bidden to private respondents.

[25] Oppenheim's International Law, Lauterpacht, Vol. I, Peace, Seventh Ed., p. 860.

[26] Union Garment Co., Inc. vs. Court of Tax Appeals, L-16809, January 31, 1962, 4 SCRA 304; see also Commissioner of Internal Revenue vs. Guerrero, L-20942, September 22, 1967, 21 SCRA 180; Republic Flour Mills, Inc. vs. Commissioner of Internal Revenue, L-25602, February 18, 1970, 31 SCRA 520.

[27] Reagan vs. Commissioner of Internal Revenue, L-26379, December 27, 1969, 30 SCRA 968.

[28] Brief, Petitioner, p. 13, et seq.

[29] CTA Records, p. 107, p. 5 of Court of Tax Appeals decision.

[30] Nasiad, et al. vs. The Court of Tax Appeals, L-29318, November 29, 1974, Second Division, per Fernando, J., 61 SCRA 244 and cases cited.

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