

COLLECTOR OF INTERNAL REVENUE, PETITIONER, VS. AMERICAN RUBBER COMPANY, AND THE COURT OF TAX APPEALS, RESPONDENTS.

G. R. No. L-10963. April 30, 1963

Ponente: PAREDES, J.

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PAREDES, J.:

The American Rubber Co. owns a tract of land with the 'approximate area of 800 hectares, planted to rubber trees in Latuan, Isabela, City of Basilah (Exh. 7). Rubber trees were planted and cultivated on said plantation for the purpose of producing latex, which in turn is processed into rubber products in the following forms: (a) Preserved Latex (Exh. J), (b) Pale crepe No. 1 Exh. H), (e) Ribbed smoke sheet No. 1 (Exh. G), (d) Ribbed smoked sheet No. 2 (Exh. O), (e) Flat bark rubber (Exh. E), (f) 2X Brown crepe (Exh. M), (g) 3X Brown crepe (Exh. N) and (h) Pale crepe No. 2 and "Campo". The company sells these rubber products locally and abroad.

On April 12, 1955, the company, filed with the respondent Collector of. Internal Revenue, a claim for refund of the the total amount of P57,703.37 representing sales tax of its various products (Exhibits E, G, H, M, N and O). The details of the payments in question are as follows:

"1. tale Crepe No. 1 (Exh. 'H')

P7,999.17

2., Bib smoked sheet No. 1 (Exh, 'G')

22,979.48

3. Bib smoked sheet No. 2 (Exh. 'O')

8,362.19.

4. 2X brown crepe (Exh. 'M')

1,572.34

5. 3X brown crope (Exh. 'N')

2,090.01

6. Flat bark rubber (Exh. 'E')

3,563.76

7. Preserved latex (Exh. 'J')

11,095.99

8. Miscellaneous (Pale Crepe No. 2 and 'Campo')

40.43

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TOTAL

P57,703.37"

Apparently, the company had waived its claim for item No. 8, because such rubber products are no longer produced by it.

The action for recovery, was instituted in the Court of Tax Appeals, simultaneously with the filing of, the claim for refund with the Collector who rendered no decision on said claim. The Court of Tax Appeals rendered a decision dated June 14, 1956, of the following tenor—

"IN VIEW OF THE FOREGOING, we are of the opinion that the sales tax amounting to P16,749.76 paid by petitioner on its sales of Preserved Latex, Flat Bark Rubber and 3X Brown Crepe, which are agricultural products, from the first quarter of 1953 to the fourth quarter of 1954 was illegally collected by respondent; while the sales tax in the sum of P40,913.18 paid by petitioner on its sales of Pale Crepe No. 1, Ribbed Smoked Sheets Nos. 1 and 2, and 2X Brown Crepe; which are manufactured articles, was collected in accordance with law. The decision of respondent denying petitioner's claim for refund of P57,662.94 is, therefore, modified accordingly, and respondent is hereby ordered to refund to petitioner the sum of P16,749.76, with costs against petitioner."

The motion for a reconsideration of the decision, filed by the company insofar as the same concerned Pale Crepe No. 1, ribbed smoked sheets Nos. 1 and 2 and 2X Brown crepe, on the ground that they were not manufactured, denied on August 27, 1956, was appealed to this Court being case G.R.No. L-11178, entitled American Rubber Company vs. Collector of Internal Revenue.

The Collector annealed the portion of the decision which Ordered him to refund the company the sum of P16,749.76 representing the sales tax on preserved latex, flat bark rubber and 3X Brown crepe, on the ground that the said products were agricultural and not manufactured products, being case G.R. No. L-10963—Collector of Internal Revenue vs. American-Rubber Co. & Court of Tax Appeals.

As both appeals stemmed from the same decision and raised the same issues, the two cases are jointly determined. The parties presented no evidence and submitted the case on the question of law, to wit: Whether the products under consideration are manufactured or agricultural products, within the meaning and contemplation of existing laws and jurisprudence.

The statement of facts "by the trial court is, admittedly, an accurate reflection of those presented during the trial.

The initial step common to the production of all the forms of crude rubber products in question is tapping, i.e., the collection of latex (rubber juice) from the rubber trees. This is done by the daily cuttings, early in the morning, of a spiral incision on the bark of the rubber trees and placing a cup below the lower end of the incision to receive the flow of juice. The collecting cup is filled after two hours. The tapper then collects this latex into buckets, carried them to the collecting shed and subsequently pours the latex collected into big milk cans. The filled milk cans are then immediately taken to a coagulating shed by motor vehicles, also within the premises of petitioner's plantation, where the latex is strained into coagulating tanks to remove foreign matters, such as leaves and dirt. After these initial steps, the processes then vary in the production of the various crude rubber products in question which the trial court described as follows:

Presented Rubber Latex (Exh. 'J')

Fresh latex is diluted with ammonia at the rate of 5 to 5-1/4 ounces to a gallon. This mixture is thoroughly stirred and the pourefi into empty metal drums. The addition of ammonia preserves the latex in liquid form and prevents its deterioration or the acquisition of a repulsive smell, at the same time maintaining its uniform color. Latex which has been 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.

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

Pale Crepe No. I (Exh. 'H'), Bibbed Smoked Sheet Nos. 1 and 2

(Exh. 'G' and 'O' respectively)

To produce Pale Crepe No. 1 and Ribbed Smoked Sheets Nos. 1 and 2, the petitioner adds to the latex in the coagulatijig tank about fifteen (15) or sixteen (16) ounces of glacial acetic acid. The mixture is stirred thoroughly after which aluminum partitions are placed crosswise inside the tank so that the latex will coagulate in uniform slabs. Acetic acid is added to the latex to hasten coagulation and to preserve its fresh state and color (Test. 'B.C. Leano, t.s.n., pp. 16 and 20 R.E. de Leon, t.s.n. pp., 40-41). The similarity in the production of Pale Crepe No. 1 and Ribbed Smoked Sheets Nos. 1 and 2 ends at the point of removing the coagulum (coagulated rubber sheets) from the coagulating tanks.

To preclude 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 in petitioner's plantation and hung for a period of about twelve or thirteen days to dry. There are no meehanieal driers used; the air drying is done naturally. As soon as the Pale Crepe is dried it is 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 ribbed coagulum is removed to petitioner's smokehouse where it is hung and exposed to heat and smoke from wood dires for about six or seven days in order to be cured. The resulting smoked sheets are sorted and classified 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 (Test. R. R. de Leon, t.s.n. 42-46,).

The petitioner's rollers are .powered by engines. If Pale Crepe No. 1 and Ribbed Smoked Sheets Nos. 1 and 2 are not air-dried and smoked, they deteriorate, get spoiled, and the color varies (Test. R. R, de Leon, t.s.n. p. 43)

Flat Baric Rubber (Exit. 'E')

Each morning before a tapper makes a fresh incission 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', which together constitute Exh. 'D' Ground and bark rubber are not intentionally produced. No chemicals are added to the latex transformed into ground and bark rubber, which, in their original for", lire not marketable (Text. R. C. Leano, t.s.n. p. 23). This kind of dried latex is spoiled a"nd has a bad odor,

'Ground' and 'bark' rubber in sufficient quantities are passed numerous times through the rollers or mills until they form a uniform mass or riheet which, finally, is called Flat Bark Rubber' (Exh. 'E'). No chemical is used to coagulate the dried 'ground' aud 'bark' rubber, because they are already coagulated. They are formed into sheets by means only of pressure of the mills or roDo's Ihrough which they are passed. Teat. B. C. Leano, t.s.n. pp. 22-24; H. E. de Leon, t.s.n. 66).

3X Drown Crepe Rubber (Exh. 'N').

Every morning, before a fresh ireif

2X Brown, Crepe, Rubber (Exft. 'M').

2X Brown Crepe is obtained by milling or rolling the excess pieces of coagulated rubber latex cup over from the smoked sheet "No. 1 (Exh. 'O') 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 chemical (Test. R. R. de Leon, t.s.n. pp. 63-64)."

The company contends that the crude rubber products it produces from its rubber plantation are essentially agricultural products and that the processes involved in their production are essentially agricultural practices performed as an incident to, or in connection with farming operations, hence it cannot be a manufacturer. Pursuant to section 188 (6) of the Revenue Code, as amended, it is argued that local sales of its crude rubber products are not subject to the sales tax imposed by section 186 of the same code.

The Collector, although not denying that the company is engaged in agriculture, maintains that the processes' used by the company, make said company a manufacturer within the purview of that term as defined in section 194 (x) of the Revenue Code. Hence, the Collector contends that the company can not avail itself of the benefits of section 188 (b) and concludes that pursuant to section 186 of the said Code, the imposition of the sales tax under consideration is valid and proper. In other words, if the rubber products are manufactured articles, original sales thereof by the company are subject to the sales tax; if they are agricultural products, the company is not subject to said tax. Section 186 of the Revenue Code imposes a percentage tax or sales tax on original sales of articles not enumerated in section 184 and 185 when the sales are made by the manufacturer or producer, as defined in section 194(a;) of the Tax Code.

The case at bar calls, therefore, for the interpretation and application of section 188(b). In a recent decision (G.R. No. L-18080, entitled *Tan Kim Kee vs. The Court of Tax Appeals, et.al.*, April 1963), the petitioner therein, ascribed the following errors against the lower court, to wit: (1) In holding that the drying out process by which the coconuts produced from petitioner's plantation are converted into copra, constitutes manufacturing as defined in section 194 (x), of the Tax Code, and (2) In failing to consider the mischievous results that would follow from its interpretation of section 194 (x) of said Code, contrary to the consistent legislative policy of encouraging farmers by exempting their products from taxation. Therein, We said—

"This case involves an interpretation of Section 188 (b) of the Tax Code, as amended by the short lived revenue statute, Republic Act: No. 1612, when applied to copra making/ Said Act took effect on 24 August 1986 until it was superceded by Rep. Act No. 1856 on 22 June 1957. This section, as it stood before and during the effectivity of Republic Act 1612, and after its subsequent amendment by Republic Act 1856, provides (all italics supplied):

Before effectivity of RA No. 1612

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

During the eleven month effectivity of RA No. 1612 '

(b) Agricultural products and the ordinary salt in their original form when sold, bartered, or exchanged by the producer or owner of the land where produced. The term 'agricultural products' as used herein shall not include cultured fish and other products raised or produced in fishponds, and those which have undergone the process of manufacturing as defined in section one hundred ninety-four (%) of this Code.'

After repeal of RA No. 1612 by RA No. 1856

'(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 by products when sold bartered or exchanged by the fisherman or fishing operator whether in their original state or not.'

The majority of the Tax Court was of the view that before the passage of Republic Act No. 1612, copra making was not taxable because the law then exempted agricultural products 'whether in their original state or not'; but that it became taxable during the effectivity of Republic Act No. 1612 because the agricultural products that were exempted under it were only those 'in their original form', and said law excluded from the exemption those which have undergone the process of manufacturing as defined in section one hundred ninety-four (x) of this Code' that provides:

'(x) 'Manufacturer' includes every person (1) 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 (2) who by any such process alters the quality of any such raw material or manufactured or partially manufactured product so as to reduce it to marketable shape or prepare it for any of the uses of industry, or (3) who by any such process combines any such raw material or manufactured or partially manufactured products with other material or products of the same or of different kinds and in such manner that the finished products of such process of 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.'

The majority of the Tax Court further held that because of the unhusking and halving of the coconut fruit, removal and cutting into pieces of its meat, and dehydrating by sun or kiln, the fruit in its original form underwent a process of manufacturing and, therefore, became taxable; but after the repeal of Republic Act 1612 by Republic Act 1856, the exempt agricultural products included once more those products 'whether in their original state or not'. It decided, therefore, that the taxability of copra making under Republic Act No. 1612 is in accordance with the legislative intent to increase revenue by imposing taxes on 'greater coverage of subjects of taxation,' as expressed in the explanatory note of House Bill 5809, the source of Republic Act 1612; and that the said section being an exempting provision, the same should be construed strictissimi juris against the party claiming exemption. * * *.

Little need be added to the foregoing disquisition, except to state that before the enactment of Rep. Act No. 1612, agricultural products whether in their original form or not, were exempt from taxation, in order to afford greater coverage to exemptions and to encourage the greater production of agricultural products, when sold, bartered or exchanged by the producer or owner of the land where produced; "by exempting agricultural products from this tax, the farming industry would be favored and the development of the resources of the country encouraged"; "that there are immense tracts of public land in this country, at present wholly unproductive, which might be made fruitful by cultivation and that large sums of money go abroad every year for the purchase of food substance, which might be grown here. Every dollar's worth of food which the farmer produces and sells in these Islands adds directly to the wealth of the country" (Molina vs. Rafferty, 38 Phil. 167) ; that during the effectivity of said Act No. 1612, exempting only agricultural products in their original form, the legislature wanted to raise greater revenue by limiting the coverage of exemptions ; but evidently, realizing that agricultural pursuit must be encouraged and too much taxation should not hamper the owners of agricultural lands who produce and sell their own products, Act No. 1856 repealed Act No. 1612, thereby returning to the former plan or policy of exempting

agricultural products, whether in their original form or not; that Rep. Act No. 2376 of June 20, 1959, reiterated the provisions of section 188 (b) as contained in Act No. 1856; and that the rubber products under consideration, having been produced and sold during the period comprising the first quarter of 1953 to the fourth quarter of 1954, and not included during the effectivity of Rep. Act No. 1612, which was from August 24, 1956 to June 22, 1957, it stands to reason that these rubber products, whether in their original form or not, are within the exemption. Only recently also, in the case of the Philippine Packing Corporation vs. Collector of Internal Revenue, 100 Phil., 545, the corporation was granted exemption from the payment of P196,060.69 as sales taxes of its products. On the question of whether or not the pineapple products were taxable, because they had been subjected to some processes, Wo said—

"* * According to the decision of the Court of Tax Appeals, the appellant subjects the fresh fruit to the following process: 'Pineapple fruits are harvested from the plants. After they are washed, peeled and sorted, then sliced, cubed, or crushed, the raw materials are placed in cans. The residual air is removed and heavy syrup, made up from a mixture of juice and sugar, is added. The cans are closed. Heat is applied to sterilize the contents, after which the cans are cooled rapidly. With respect to the canned pineapple juice, no sugar is added. Unless preserved in tin cans, fresh pineapple fruits are very perishable and will not keep longer than two days.' (Annex 'A' p. 13).

The main issue is whether the domestic sales of pineapples and pineapple products grown and canned by appellants are exempted from tax under Sec. 188 (b) of the Int. Rev. Code providing:

"We find ourselves unable to agree with the Court of Tax Appeals that because the manipulations to which appellant subjects the fresh pineapple fruit grown by it amount to a manufacturing process, that the sale of the canned products becomes a taxable sale of manufactured goods, and not an exempt sale of agricultural products. The very text of the law, in exempting 'agricultural products—whether in their original state or not,' makes it clear that the exemption is not divested merely because the products themselves have undergone processing of some kind. At what particular stage the extent of the manufacturing process extinguished or supersedes the agricultural character of the product can not be predetermined in advance. But such uncertainties are no obstacle to the application or refusal of the exemption in specific cases. We believe the case before us can be determined following the test set by this Court in *Central Azucarera de Filipinas vs. Trinidad*, 46 Phil. 492, 499:

'A planter who devotes himself to the production of sugar cane and as an incident to such production works his product into a more convenient and valuable form is primarily a planter; his manufacturing is merely an incident to the management of his plantation. His case is manifestly different from that of the plaintiff corporation which, in effect, buys its raw materials and devotes itself exclusively, to converting it into finished merchandise. It may, perhaps, not always be easy to draw the line of demarcation between one business and the other, but difficulties of that sort are frequently encountered in the interpretation of the law.'

The facts on record in the case before us clearly indicate that the canning of appellant's products is a mere incident and consequence of its large scale production of pineapples. Appellant perforce had to resort to a preserving process, for the volume of products (170,000 tons) made it impossible to dispose of the same in the total market. The pineapple could not be sold in the open market unless properly ripened; on the other hand, once ripened, the fruit would quickly deteriorate, and become unsaleable, unless the deterioration was arrested by some preservative process, which thus becomes an essential part of the production and disposition of the fruit. We believe that the legislature, in providing a tax exemption for agricultural products, 'whether in their original state or not', had precisely in mind that fruit crops could not be raised and sold on a large scale without resort to some process to prevent their deterioration.

"The state has not shown that the canned products of appellant corporation have acquired, as a consequence of the processing to which they are subjected, any use to which the original fruit was not suited, or could not be

devoted. It is practically admitted " (and the Court may well take judicial cognizance thereof) that the nature, qualities and texture of the product are in no way altered, and it distinctly remains an agricultural product. Certainly' the canned pineapples as compared to the original fruit have undergone much less change than that found in the case of centrifugal sugar obtained from the sugar cane or of abaca fiber when compared with the raw plant stalks. And yet the state admits that the sugar from the cane is exempt from the tax under sec. 188 (b) of the Internal Revenue Code.

"* *. It directly produces its goods from the cultivation of land, merely engaging in the suitable preservative processes for the purpose of making the product available at all times without regard to seasons, and in markets that would not be accessible to the fresh fruit. Appellant does not make its profit upon floods produced by others, and there is no reason why it should not be given the protection that the law affords.

'Public policy has long favored the exemption of agricultural producers from the taxation of the methods employed by them to put their products upon the market, for the preparation transportation, and direct sale by the farmer produce raised by himself is not engagement in a trade, but incident to his business of production. Thus, the exemption or especially favorable Classification of farmers, their produce' or their vehicles hauling agricultural products to markets in statutes imposing business, occupational and sales taxes, in statutory trade license provisions, and in highway transportation tax or registration laws, has in a number of cases been held to be, based upon a reasonable classification.' (2 Am. Jur. pp. 399-400).

"The interpretation adopted by the Court of Tax Appeals would limit the benefits of the tax exemption under sec. 188 (b) of the Tax Code to small scale farmers and producers, who can dispose of their products within the short time within the ripening of the fruit. Were this the legislative intent, the exemption for agricultural products would have been unnecessary, since the same section already exempts, directly and expressly, —*" (said farmers and producers).

"With the small producers and merchants already guarded and fostered by the provisions above quoted, we see no reason why the further exemption of agricultural products 'whether in their original state or not' should not apply to large scale agricultural production and its incidental process, x x x Similarly, the American authorities cited for the State refer to manufacturers that are not the growers of the products processed by them; which is precisely the reason why the sugar mills or centrals exclusively devoted to processing the planters' sugar cane, are not exempted from the tax, being, as they are, primarily manufacturers and not producers of agricultural crops. The appellant's situation is just the contrary. * * *"

Considering that, in principle, the processes to which the pineapple fruits were subjected in the above-cited case, are similar to, if not the same as, the processes to which the latex had been submitted, We see no plausible reason why the rubber products in question, should not be extended the same exemption.

In view hereof, the respondent Collector of Internal Revenue is ordered to refund to petitioner American Rubber Company, the sum of P57,662.94, representing Sales Taxes collected by him, on the said rubber products, corresponding to the first quarter of 1953 to the fourth quarter of 1954. As thus modified, the decision appealed from is hereby AFFIRMED, in all other respects, without pronouncement as to costs.

Bengzon, C. J., Bautista Angelo, Labrador, Concepcion, Reyes, J.B.L., Barrera, Dizon, Regala and Makalintal, JJ., concur.

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