

THE COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. ENGINEERING EQUIPMENT AND SUPPLY COMPANY AND THE COURT OF TAX APPEAL, RESPONDENTS.

G.R. No. L-27044. June 30, 1975

Ponente: ESGUERRA, J.

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ESGUERRA, J.:

Petition for review on certiorari of the decision of the Court of Tax Appeals in CTA Case No. 681, dated November 29, 1966, assessing a compensating tax of P174,441.62 on the Engineering Equipment and Supply Company.

As found by the Court of Tax Appeals, and as established by the evidence on record, the facts of this case are as follows:

Engineering. Equipment and Supply Co. (Engineering for short), a domestic corporation, is an engineering and machinery firm. As operator of an integrated engineering shop, it is engaged, among others, in the design and installation of central type air conditioning system, pumping plants and steel fabrications. (Vol. I pp. 12-16 T.S.N. August 23, 1960)

On July 27, 1956, one Juan de la Cruz, wrote the then Collector, now Commissioner, of Internal Revenue denouncing Engineering for tax evasion by misdeclaring its imported articles and failing to pay the correct percentage taxes due thereon in connivance with its foreign suppliers (Exh. "2" p. 1 BIR record Vol. I). Engineering was likewise denounced to the Central Bank (CB) for alleged fraud in obtaining its dollar allocations. Acting on these denunciations, a raid and search was conducted by a joint team of Central Bank, (CB), National Bureau of Investigation (NBI) and Bureau of Internal Revenue (BIR) agents on September 27, 1956, on which occasion voluminous records of the firm were seized and confiscated. (pp. 173-177 T.S.N.)

On September 30, 1957, revenue examiners Quesada and Catudan reported and recommended to the then Collector, now Commissioner, of Internal Revenue (hereinafter referred to as Commissioner) that Engineering be assessed for P480,912.01 as deficiency advance sales tax on the theory that it misdeclared its importation of air conditioning units and parts and accessories thereof which are subject to tax under Section 185(m)[1] of the Tax Code, instead of Section 186 of the same Code. (Exh. "3" pp. 59-63 BIR rec. Vol. I) This assessment was revised on January 23, 1959, in line with the observation of the Chief, BIR Law Division, and was raised to P916,362.56 representing deficiency advance sales tax and manufacturers sales tax, inclusive of the 25% and 50% surcharges. (pp. 72-80 BIR rec. Vol. I)

On March 3, 1959, the Commissioner assessed against, and demanded upon, Engineering payment of the increased amount and suggested that P10,000 be paid as compromise in extrajudicial settlement of Engineering's penal liability for violation of the Tax Code. The firm, however, contested the tax assessment and requested that it be furnished with the details and particulars of the Commissioner's assessment. (Exh. "B" and "15", pp. 86--88 BIR rec. Vol. 1) The Commissioner replied that the assessment was in accordance with law and the facts of the

case.

On July 30, 1959, Engineering appealed the case to the Court of Tax Appeals and during the pendency of the case the investigating revenue examiners reduced Engineering's deficiency tax liabilities from P916,362.65 to P740,587.86 (Exhs. "R" and "9" pp. 162-170, BIR rec.), based on findings after conferences had with Engineering's Accountant and Auditor.

On November 29, 1966, the Court of Tax Appeals tendered its decision, the dispositive portion of which reads as follows:

"For ALL THE FOREGOING CONSIDERATIONS, the decision of respondent appealed from is hereby modified, and petitioner, as a contractor, is declared exempt from the deficiency manufacturers sales tax covering the period from June 1, 1948, to September 2, 1956. However, petitioner is ordered to pay respondent, or his duly authorized collection agent, the sum of P174,141.62 as compensating tax and 25% surcharge for the period from 1953 to September 1956. With costs against petitioner."

The Commissioner, not satisfied with the decision of the Court of Tax Appeals, appealed to this Court on January 18, 1967, (G.R. No. L-27044). On the other hand, Engineering, on January 4, 1967, filed with the Court of Tax Appeals a motion for reconsideration of the decision abovementioned. This was denied on April 6, 1967, prompting Engineering to file also with this Court its appeal, docketed as G.R. No. L-27452.

Since the two cases, G.R. No. L-27044 and G.R. No. L-27452, involve the same parties and issues, We have decided to consolidate and jointly decide them.

Engineering in its petition claims that the Court of Tax Appeals committed the following errors:

- That the Court of Tax Appeals erred in holding Engineering Equipment & Supply Company liable to the 30% compensating tax on its importations of equipment and ordinary articles used in the central type air conditioning systems it designed, fabricated, constructed and installed in the buildings and premises of its customers, rather than to the compensating tax of only 7%;
- That the Court of Tax Appeals erred in holding Engineering Equipment & Supply Company guilty of fraud in effecting the said importations on the basis of incomplete quotations from the contents of alleged photostat copies of documents seized illegally from Engineering Equipment and Supply Company which should not have been admitted in evidence;
- That the Court of Tax Appeals erred in holding Engineering Equipment & Supply Company liable to the 25% surcharge prescribed in Section 190 of the Tax Code;
- That the Court of Tax Appeals erred in holding the assessment as not having prescribed;
- That the Court of Tax Appeals erred in holding Engineering Equipment & Supply Company liable for the sum of P174,141.62 as 30% compensating tax and 25% surcharge instead of completely absolving it from the deficiency assessment of the Commissioner.

The Commissioner on the other hand claims that the Court of Tax Appeals erred:

- In holding that the respondent company is a contractor and not a manufacturer;
- In holding respondent company liable to the 3% contractor's tax imposed by Section 191 of the Tax Code instead of the 30% sales tax prescribed in Section 185(m) in relation to Section 194(x) both of the same Code;
- In holding that the respondent company is subject only to the 30% compensating tax under Section 190 of the Tax Code and not to the 30% advance sales tax imposed by section 183 (b), in relation to section 185(m) both of the same Code, on its importations of parts and accessories of air conditioning units;

- In not holding the company liable to the 50% fraud surcharge under Section 183 of the Tax Code on its importations of parts and accessories of air conditioning units, notwithstanding the finding of said court that the respondent company fraudulently misdeclared the said importations;
- In holding the respondent company liable for P174,141.62 as compensating tax and 25% surcharge instead of P740,587.86 as deficiency advance sales tax, deficiency manufacturers tax and 25% and 50% surcharge for the period from June 1, 1948 to December 31, 1956.

The main issue revolves on the question of whether or not Engineering is a manufacturer of air conditioning units under Section 185(m), supra, in relation to Sections 183(b) and 194 of the Code, or a contractor under Section 191 of the same Code.

The Commissioner contends that Engineering is a manufacturer and seller of air conditioning units and parts or accessories thereof and, therefore, it is subject to the 30% advance sales tax prescribed by Section 185(m) of the Tax Code, in relation to Section 194 of the same, which defines a manufacturer as follows:

"Section 194. — Words and Phrases Defined. — In applying the provisions of this Title, words and phrases shall be taken in the sense and extension indicated below:

x x x x x x x x

(x) "Manufacturer" includes every person who by physical or chemical process alters the exterior texture or form or inner substance of any raw material or manufactured or partially manufactured products in such manner as to prepare it for a special use or uses to which it could not have been put in its original condition, or who by any such process alters the quality of any such 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 who by any such process combines any such raw material or manufactured or partially manufactured products with other materials or products of the same or of different kinds and in such manner that the finished product of such process of manufacture can be put to 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.

In answer to the above contention, Engineering claims that it is not a manufacturer and seller of air-conditioning units and spare parts or accessories thereof subject to tax under Section 185(m) of the Tax Code, but a contractor engaged in the design, supply and installation of the central type of air-conditioning system subject to the 3% tax imposed by Section 191 of the same Code, which is essentially a tax on the sale of services or labor of a contractor rather than on the sale of articles subject to the tax referred to in Sections 184, 185 and 186 of the Code.

The arguments of both the Engineering and the Commissioner call for a clarification of the term contractor as well as the distinction between a contract of sale and a contract for furnishing services, labor and materials. The distinction between a contract of sale and one for work, labor and materials is tested by the inquiry whether the thing transferred is one not in existence and which never would have existed but for the order of the party desiring to acquire it, or a thing which would have existed and has been the subject of sale to some other persons even if the order had not been given.[2] If the article ordered by the purchaser is exactly such as the plaintiff makes and keeps on hand for sale to anyone, and no change or modification of it is made at defendant's request, it is a contract of sale, even though it may be entirely made after, and in consequence of, the defendant's order for it.[3]

Our New Civil Code, likewise distinguishes a contract of sale from a contract for a piece of work thus:

"Art. 1467. A contract for the delivery at a certain price of an article which the vendor in the ordinary course of

his business manufactures or procures for the general market, whether the same is on hand at the time or not, is a contract of sale, but if the goods are to be manufactured specially for the customer and upon his special order and not for the general market, it is a contract for a piece of work."

The word "contractor" has come to be used with special reference to a person who, in the pursuit of the independent business, undertakes to do a specific job or piece of work for other persons, using his own means and methods without submitting himself to control as to the petty details. (Arañas, Annotations and Jurisprudence on the National Internal Revenue Code, p. 318, par. 191 (2), 1970 Ed.) The true test of a contractor as was held in the cases of Luzon Stevedoring Co., vs. Trinidad 43, Phil. 803, 807-808, and La Carlota Sugar Central vs. Trinidad 43, Phil. 816, 819, would seem to be that he renders service in the course of an independent occupation, representing the will of his employer only as to the result of his work, and not as to the means by which it is accomplished.

With the foregoing criteria as guideposts, We shall now examine whether Engineering really did "manufacture" and sell, as alleged by the Commissioner to hold it liable to the advance sales tax under Section 185(m), or it only had its services "contracted" for installation purposes to hold it liable under section 198 of the Tax Code.

I

After going over the three volumes of stenographic notes and the voluminous record of the BIR and the CTA as well as the exhibits submitted by both parties, We find that Engineering did not manufacture air conditioning units for sale to the general public, but imported some items (as refrigeration compressors in complete set, heat exchangers or coils, t.s.n. p. 39) which were used in executing contracts entered into by it. Engineering, therefore, undertook negotiations and execution of individual contracts for the design, supply and installation of air conditioning units of the central type. (t.s.n. pp. 20-36; Exhs. "F", "G", "H", "I", "J", "K", "L", and "M"), taking into consideration in the process such factors as the area of the space to be air conditioned; the number of persons occupying or would be occupying the premises; the purpose for which the various air conditioning areas are to be used; and the sources of heat gain or cooling load on the plant such as sun load, lighting, and other electrical appliances which are or may be in the plan. (t.s.n. p. 34, Vol. I) Engineering also testified during the hearing in the Court of Tax Appeals that relative to the installation of air conditioning system, Engineering designed and engineered complete each particular plant and that no two plants were identical but each had to be engineered separately.

As found by the lower court, which finding[4] We adopt —

"Engineering, in a nutshell, fabricates, assembles, supplies and installs in the buildings of its various customers the central type air conditioning system; prepares the plans and specifications therefor which are distinct and different from each other; the air conditioning units and spare parts or accessories thereof used by petitioner are not the window type of air conditioner which are manufactured, assembled and produced locally for sale to the general market; and the imported air conditioning units and spare parts or accessories thereof are supplied and installed by petitioner upon previous orders of its customers conformably with their needs and requirements."

The facts and circumstances aforequoted support the theory that Engineering is a contractor rather than a manufacturer.

The Commissioner in his Brief argues that "it is more in accord with the reason and sound business management to say that anyone who desires to have air conditioning units installed in his premises and who is in a position and willing to pay the price can order the same from the company (Engineering) and, therefore, Engineering could have mass produced and stockpiled air conditioning units for sale to the public or to any customer with enough

money to buy the same." This is untenable in the light of the fact that air conditioning units, packaged, or what we know as self-contained air conditioning units, are distinct from the central system which Engineering dealt in. To Our mind, the distinction as explained by Engineering, in its Brief, quoting from books, is not an idle play of words as claimed by the Commissioner, but a significant fact which We just cannot ignore. As quoted by Engineering Equipment & Supply Co., from an Engineering handbook by L. C. Morrow, and which We reproduce hereunder for easy reference:

"x x x there is a great variety of equipment in use to do this job (of air conditioning). Some devices are designed to serve a specific type of space; others to perform a specific function; and still others as components to be assembled into a tailor-made system to fit a particular building. Generally, however, they may be grouped into two classifications — unitary and central system.

"The unitary equipment classification includes those designs such as room air conditioner, where all of the functional components are included in one or two packages, and installation involves only making service connection such as electricity, water and drains. Central-station systems, often referred to as applied or built-up systems, require the installation of components at different points in a building and their interconnection.

"The room air conditioner is a unitary equipment designed specifically for a room or similar small space. It is unique among air conditioning equipment in two respects: It is in the electrical appliance classification, and it is made by a great number of manufacturers."

There is also the testimony of one Carlos Navarro, a licensed Mechanical and Electrical Engineer, who was once the Chairman of the Board of Examiners for Mechanical Engineers and who was allegedly responsible for the preparation of the refrigeration and air conditioning code of the City of Manila, who said that "the central type air conditioning system is an engineering job that requires planning and meticulous layout due to the fact that usually architects assign definite space and usually the spaces they assign are very small and of various sizes. Continuing further, he testified:

"I don't think I have seen central type of air conditioning machinery room that are exactly alike because all our buildings here are designed by architects dissimilar to existing buildings, and usually they don't coordinate and get the advice of air conditioning and refrigerating engineers so much so that when we come to design, we have to make use of the available space that they are assigning to us so that we have to design the different component parts of the air conditioning system in such a way that will be accommodated in the space assigned and afterwards the system may be considered as a definite portion of the building. x x x"

"Definitely there is quite a big difference in the operation because the window type air conditioner is a sort of compromise. In fact, it cannot control humidity to the desired level; rather the manufacturers, by hit and miss, were able to satisfy themselves that the desired comfort within a room could be made by a definite setting of the machine as it comes from the factory; whereas the central type system definitely requires an intelligent operator." (t.s.n. pp. 301-335, Vol. II)

The point, therefore, is this — Engineering definitely did not and was not engaged in the manufacture of air conditioning units but had its services contracted for the installation of a central system. The cases cited by the Commissioner (Advertising Associates Inc. vs. Collector of Customs, 97, Phil. 636; Celestino Co & Co. vs. Collector of Internal Revenue, 99 Phil. 841 and Manila Trading & Supply Co. vs. City of Manila, 56 O. G. 3629), are not in point. Neither are they applicable because the facts in all the cases cited are entirely different. Take for instance the case of Celestino Co where this Court held the taxpayer to be a manufacturer rather than a contractor of sash, doors and windows manufactured in its factory. Indeed, from the very start, Celestino Co intended itself to be a manufacturer of doors, windows, sashes etc. as it did register a special trade name for its sash business and ordered company stationery carrying the bold print "ORIENTAL SASH FACTORY (CELESTINO CO AND

COMPANY, PROP.) 926 Raon St., Quiapo, Manila, Tel. No. etc., Manufacturers of All Kinds of Door, Windows" Likewise, Celestino Co never put up a contractor's bond as required by Article 1729 of the Civil Code. Also, as a general rule, sash factories receive orders for doors and windows of special design only in particular cases, but the bulk of their sales is derived from ready-made doors and windows of standard sizes for the average home, which "sales" were reflected in their books of accounts totalling P118,754.69 for the period from January, 1952 to September 30, 1952, or for a period of only nine (9) months. This Court found said sum difficult to have been derived from its few customers who placed special orders for these items. Applying the abovestated facts to the case at bar, We found them to be inapposite. Engineering advertised itself as Engineering Equipment and Supply Company, Machinery Mechanical Supplies, Engineers, Contractors, 174 Marques de Comillas, Manila (Exh. "B" and "15" BIR rec. p. 186), and not as manufacturers. It likewise paid the contractors tax on all the contracts for the design and construction of central system as testified to by Mr. Rey Parker, its President and General Manager. (t.s.n. p. 102, 103) Similarly, Engineering did not have ready-made air conditioning units for sale but as per testimony of Mr. Parker upon inquiry of Judge Luciano of the CTA —

Q - "Aside from the general components, which go into air conditioning plant or system of the central type which your company undertakes, and the procedure followed by you in obtaining and executing contracts which you have already testified to in previous hearing, would you say that the covering contracts for these different projects listed . . . referred to in the list, Exh. "F" are identical in every respect? I mean, every plan or system covered by these different contracts are identical in standard in every respect, so that you can reproduce them?

A - "No, sir. They are not all standard. On the contrary, none of them are the same. Each one must be designed and constructed to meet the particular requirements, whether the application is to be operated. (t.s.n. pp. 101-102)

What We consider as on all fours with the case at bar is the case of *S.M. Lawrence Co. vs. McFarland, Commissioner of Internal Revenue of the State of Tennessee and McCanless*, 355 SW 2d, 100, 101, "where the cause presents the question of whether one engaged in the business of contracting for the establishment of air conditioning system in buildings, which work requires, in addition to the furnishing of a cooling unit, the connection of such unit with electrical and plumbing facilities and the installation of ducts within and through walls, ceilings and floors to convey cool air to various parts of the building, is liable for sale or use tax as a contractor rather than a retailer of tangible personal property. Appellee took the position that appellant was not engaged in the business of selling air conditioning equipment as such but in the furnishing to its customers of completed air conditioning systems pursuant to contract, was a contractor engaged in the construction or improvement of real property, and as such was liable for sales or use tax as the consumer of materials and equipment used in the consummation of contracts, irrespective of the tax status of its contractors. To transmit the warm or cool air over the buildings, the appellant installed systems of ducts running from the basic units through walls, ceilings and floors to registers. The contract called for completed air conditioning systems which became permanent part of the buildings and improvements to the realty." The Court held the appellant a contractor which used the materials and the equipment upon the value of which the tax herein imposed was levied in the performance of its contracts with its customers, and that the customers did not purchase the equipment and have the same installed.

Applying the facts of the aforementioned case to the present case, We see that the supply of air conditioning units to Engineering's various customers, whether the said machineries were on hand or not, was specially made for each customer and installed in his building upon his special order. The air conditioning units installed in a central type of air conditioning system would not have existed but for the order of the party desiring to acquire it and if it existed without the special order of Engineering's customer, the said air conditioning units were not intended for

sale to the general public. Therefore, We have but to affirm the conclusion of the Court of Tax Appeals that Engineering is a contractor rather than a manufacturer, subject to the contractors tax prescribed by Section 191 of the Code and not to the advance sales tax imposed by Section 185(m) in relation to Section 194 of the same Code. Since it has been proved to Our satisfaction that Engineering imported air conditioning units, parts or accessories thereof for use in its construction business and these items were never sold, resold; bartered or exchanged, Engineering should be held liable to pay taxes prescribed under Section 190[5] of the Code. This compensating tax is not a tax on the importation of goods but a tax on the use of imported goods not subject to sales tax. Engineering, therefore, should be held liable to the payment of 30% compensating tax in accordance with Section 190 of the Tax Code in relation to Section 185(m) of the same, but without the 50% mark up provided in Section 183(b).

II

We take up next the issue of fraud. The Commissioner charged Engineering with misdeclaration of the imported air conditioning units and parts or accessories thereof so as to make them subject to a lower rate of percentage tax (7%) under Section 186 of the Tax Code, when they are allegedly subject to a higher rate of tax (30%) under its Section 185(m). This charge of fraud was denied by Engineering but the Court of Tax Appeals in its decision found adversely and said:

"x x x We are amply convinced from the evidence presented by respondent that petitioner deliberately and purposely misdeclared its importations. This evidence consists of letters written by petitioner to its foreign suppliers, instructing them on how to invoice and describe the air conditioning units ordered by petitioner. x x x" (p. 218 CTA rec.)

Despite the above findings, however, the Court of Tax Appeals absolved Engineering from paying the 50% surcharge prescribed by Section 183(a) of the Tax Code by reasoning out as follows:

"The imposition of the 50% surcharge prescribed by Section 183(a) of the Tax Code is based on willfull neglect to file the monthly return within 20 days after the end of each month or in case a false or fraudulent return is willfully made, it can readily be seen that petitioner cannot legally be held subject to the 50% surcharge imposed by Section 183(a) of the Tax Code. Neither can petitioner be held subject to the 50% surcharge under Section 190 of the Tax Code dealing on compensating tax because the provisions thereof do not include the 50% surcharge. Where a particular provision of the Tax Code does not impose the 50% surcharge as fraud penalty we cannot enforce a non-existing provision of law notwithstanding the assessment of respondent to the contrary. Instances of the exclusion in the Tax Code of the 50% surcharge are those dealing on tax on banks, taxes on receipts of insurance companies, and franchise tax. However, if the Tax Code imposes the 50% surcharge as fraud penalty, it expressly so provides as in the cases of income tax, estate and inheritance taxes, gift taxes, mining tax, amusement tax and the monthly percentage taxes. Accordingly, we hold that petitioner is not subject to the 50% surcharge despite the existence of fraud in the absence of legal basis to support the importation thereof." (p. 228 CTA rec.)

We have gone over the exhibits submitted by the Commissioner evidencing fraud committed by Engineering and We reproduce some of them hereunder for clarity.

As early as March 18, 1953, Engineering in a letter of even date wrote to Trane Co. (Exh. "3-K" pp. 152-155, BIR rec.) viz:

"Your invoices should be made in the name of Madrigal & Co. Inc., Manila, Philippines, c/o Engineering Equipment & Supply Co., Manila, Philippines - forwarding all correspondence and shipping papers concerning this order to us only and not to the customer.

"When invoicing, your invoices should be exactly as detailed in the customer's Letter Order dated March 14th, 1953 attached. This is in accordance with the Philippine import licenses granted to Madrigal & Co., Inc. and such details must only be shown on all papers and shipping documents for this shipment. No mention of the words air conditioning equipment should be made on any shipping documents as well as on the cases. Please give this matter your careful attention, otherwise great difficulties will be encountered with the Philippine Bureau of Customs when clearing the shipment on its arrival in Manila. All invoices and cases should be marked 'THIS EQUIPMENT FOR RIZAL CEMENT CO.'"

The same instruction was made to Acme Industries, Inc., San Francisco, California in a letter dated March 19, 1953 (Exh. "3-J-1" pp. 150-151. BIR rec.)

On April 6, 1953, Engineering wrote to Owens-Corning Fiberglass Corp., New York, U.S.A. (Exh. "3-1" p. 147-149, BIR rec.) also enjoining the latter from mentioning or referring to the term 'air conditioning' and to describe the goods on order as Fiberglass pipe and pipe fitting insulation instead. Likewise on April 30, 1953, Engineering threatened to discontinue the forwarding service of Universal Transcontinental Corporation when it wrote Trane Co. (Exh. "3-H" p. 146, BIR rec.):

"It will be noted that Universal Transcontinental Corporation is not following through on the instructions which have been covered by the above correspondence, and which indicates the necessity of discontinuing the use of the term 'Air conditioning Machinery or Air Coolers'. Our instructions concerning this general situation have been sent to you in ample time to have avoided this error in terminology, and we will ask that on receipt of this letter that you again write to Universal Transcontinental Corp. and inform them that, if in the future, they are unable to cooperate with us on this requirement, we will thereafter be unable to utilize their forwarding service. Please inform that we will not tolerate another failure to follow our requirements."

And on July 17, 1953 (Exh. "3-g", p. 145, BIR rec.) Engineering wrote Trane Co. another letter, viz:

"In the past, we have always paid the airconditioning tax on climate changers and that mark is recognized in the Philippines as air conditioning equipment. This matter of avoiding any tie-in on air conditioning is very important to us, and we are again asking that from hereon that whoever takes care of the processing of our orders be carefully instructed so as to avoid again using the term 'climate changers' or in any way referring to the equipment as 'air conditioning.'

And in response to the aforequoted letter, Trane Co. wrote on July 30, 1953, suggesting a solution, viz:

"We feel that we can probably solve all the problems by following the procedure outlined in your letter, of March 25, 1953, wherein you stated that in all future jobs you would enclose photostatic copies of your import license so that we might make up two sets of invoices: one set describing equipment ordered simply according to the way that they are listed on the import license and another according to our ordinary regular methods of order write-up. We would then include the set made up according to the import license in the shipping boxes themselves and use those items as our actual shipping documents and invoices, and we will send the other regular invoice to you, by separate correspondence. (Exh. No. "3F-1", p. 144 BIR rec.)

Another interesting letter of Engineering is one dated August 27, 1955 (Exh. "3-C" p. 141 BIR rec.)

"In the process of clearing the shipment from the piers, one of the Customs inspectors requested to see the packing list. Upon locating the packing list, it was discovered that the same was prepared on a copy of your letterhead which indicated that the Trane Co. manufactured air conditioning, heating and heat transfer equipment. Accordingly, the inspectors insisted that this equipment was being imported for air conditioning purposes. To date, we have not been able to clear the shipment and it is possible that we will be required to pay heavy taxes on the equipment.

"The purpose of this letter is to request that in the future, no documents of any kind should be sent with the

order that indicate in any way that the equipment could possibly be used for air conditioning.

'It is realized that this is a broad request and fairly difficult to accomplish and administer, but we believe with proper caution it can be executed. Your cooperation and close supervision concerning these matters will be appreciated.' (Italics supplied)

The aforequoted communications are strongly indicative of the fraudulent intent of Engineering to misdeclare its importation of air conditioning units and spare parts or accessories thereof to evade payment of the 30% tax. And since the commission of fraud is altogether too glaring, We cannot agree with the Court of Tax Appeals in absolving Engineering from the 50% fraud surcharge, otherwise We will be giving premium to a plainly intolerable act of tax evasion. As aptly stated by then Solicitor General, now Justice, Antonio P. Barredo: this circumstance will not free it from the 50% surcharge because in any case whether it is subject to advance sales tax or compensating tax, it is required by law to truly declare its importation in the import entries and internal revenue declarations before the importations maybe released from customs custody. The said entries are the very documents where the nature, quantity and value of the imported goods are declared and where the customs duties, internal revenue taxes and other fees or charges incident to the importation are computed. These entries, therefore, serve the same purpose as the returns required by Section 183 (a) of the Code.'

Anent the 25% delinquency surcharge, We fully agree to the ruling made by the Court of Tax Appeals and hold Engineering liable for the same. As held by the lower court:

"At first blush it would seem that the contention of petitioner that it is not subject to the delinquency surcharge of 25% is sound, valid and tenable. However, a serious study and critical analysis of the historical provisions of Section 190 of the Tax Code dealing on compensating tax in relation to Section 183 (a) of the same Code, will show that the contention of petitioner is without merit. The original text of Section 190 of Commonwealth Act 466, otherwise known as the National Internal Revenue Code, as amended by Commonwealth Act No. 503, effective on October 1, 1939, does not provide for the filing of a compensating tax return and payment of the 25% surcharge for late payment thereof. Under the original text of Section 190 of the Tax Code, as amended by Commonwealth Act No. 503, the contention of the petitioner that it is not subject to the 25% surcharge appears to be legally tenable. However, Section 190 of the Tax Code was subsequently amended by Republic Acts Nos. 48, 253, 361, 1511 and 1612 effective October 1, 1946, July 1, 1948, June 9, 1949, June 16, 1956 and August 24, 1956 respectively, which invariably provides among others, the following:

"... If any article withdrawn from the customhouse or the post office without -payment of the compensating tax is subsequently used by the importer for other purposes, corresponding entry should be made in the books of accounts if any are kept or a written notice thereof sent to the Collector of Internal Revenue and payment of the corresponding compensating tax made within 30 days from the date of such entry or notice and if tax is not paid within such period the amount of the tax shall be increased by 25% the increment to be a part of the tax."

"Since the imported air conditioning units and spare parts or accessories thereof are subject to the compensating tax of 30% as the same were used in the construction business of Engineering, it is incumbent upon the latter to comply with the aforequoted requirement of Section 190 of the Code, by posting in its books of accounts or notifying the Collector of Internal Revenue that the imported articles were used for other purposes within 30 days. . . . Consequently, as the 30% compensating tax was not paid by petitioner within the time prescribed by Section 190 of the Tax Code as amended, it is therefore subject to the 25% surcharge for delinquency— in the payment of the said tax." (pp. 224-226 CTA rec.)

III

Lastly the question of prescription of the tax assessment has been put in issue. Engineering contends that it was not guilty of tax fraud in effecting the importations and, therefore, Section 332(a) prescribing ten years is inapplicable, claiming that the pertinent prescriptive period is five years from the date the questioned importations were made. A review of the record however reveals that Engineering did file a tax return or declaration with the Bureau of Customs before it paid the advance sales tax of 7%. And the declaration filed reveals that it did in fact misdeclare its importations. Section 332 of the Tax Code which provides:

"Section 332. — Exceptions as to period of limitation of assessment and collection of taxes. —

(a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment at any time within ten years after the discovery of the falsity, fraud or omission.

is applicable, considering the preponderance of evidence of fraud with the intent to evade the higher rate of percentage tax due from Engineering. The tax assessment was made within the period prescribed by law and prescription had not set in against the Government.

WHEREFORE, the decision appealed from is affirmed with the modification that Engineering is hereby also made liable to pay the 50% fraud surcharge.

SO ORDERED.

Makalintal, C.J., Castro, Makasiar, and Martin, JJ., concur.

[1] "Section 185. Percentage tax on sales of ..., refrigerators and others. — There shall be levied, assessed and collected once only on every original sale, barter, exchange, or similar transaction intended to transfer ownership of, or title to, the other articles herein below enumerated, a tax equivalent to thirty percentum of the gross selling price or gross value in money of the articles sold, bartered, exchanged or transferred, such tax to be paid by the manufacturer or producers, Provided: That where the articles enumerated herein below are manufactured out of materials subject to tax under this section, 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.

xxx xxx xxx

(m) Air conditioning units and parts or accessories thereof. (As amended by R.A. No. 588, effective from September 22, 1950 until it was amended by R.A. No. 1612 made effective August 14, 1956.)

[2] Groves vs. Buck. 3. Maule & s. 178; Towers vs. Osborne, I Strange 506, Benjamin on Sales 90; as cited in Arañas Annotations and Jurisprudence on the NIRC as amended. 1970 ed. p. 323. 324.

[3] Ibid, p. 324, par. 191 (13).

[4] Decision, Court of Tax Appeals, CIA Rec. p. 212.

[5] "Section 190. Compensating tax — All persons residing or doing business in the Philippines, who purchase or receive from without the Philippines any commodities, goods, wares or merchandise, excepting those subject to specific taxes under Title IV of this Code, shall pay on the total value thereof at the time they are received by such persons, including freight, postage, insurance, commission and all similar charges, a compensating tax equivalent to the percentage taxes imposed under this Title on original transactions effected by merchants, importers or

manufacturers, such tax to be paid before the withdrawal or removal of said commodities, goods, wares or merchandise from the custom house or the post office. Provided, However, That merchants, importers, and manufacturers, who are subject to the tax under Sections 184, 185, 186 or 189 of this Title, shall not be required to pay the herein tax imposed where such commodities, goods wares or merchandise purchased or received by them from without the Philippines are to be sold, resold, bartered or exchanged or are to be used in the manufacture or preparation of articles for sale, barter or exchange and are to form part thereof. And Provided, Further, that the tax imposed in this section shall not apply to articles to be used by the importer himself in the manufacture or preparation of articles subject to specific tax, or those for consignment abroad and are to form part thereof. If any article withdrawn from the customhouse or the post office without payment of the compensating tax is subsequently used by the importer for other purposes, corresponding entry should be made in the books of accounts, if any are kept or written notice thereof sent to the Collector of Internal Revenue and payment of the corresponding compensating tax made within 10 days from the date of such entry or notice. If the tax is not paid within such period the amount of the tax shall be increased by 25%, the increment to be a part of the tax". (As amended by R.A. 253, effective July 1948)

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