COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. LA CAMPANA FABRICA DE TABACOS, INC., RESPONDENT.

G.R. No. 145275. November 15, 2001

Ponente: PARDO, J.

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PARDO, J.:

The Case

Appeal via certiorari from the decision of the Court of Appeals[1] affirming the decision of the Court of Tax Appeals canceling the assessment issued against respondent for deficiency specific tax on stemmed leaf tobacco in the amount of P2,785,338.75, covering the period from January 1, 1986 to June 30, 1989.

The Facts

The facts, as found by the Court of Appeals, are as follows:

> "Respondent is a domestic corporation engaged in, among others, the importation and local purchase of stemmed leaf tobacco which it uses as raw material in the production and manufacture of cigar and cigarettes.
>
> "On January 4, 1990, Respondent received from Petitioner a letter dated December 18, 1989, demanding payment of P2,785,338.75 representing deficiency excise tax, exclusive of surcharge and interest on Respondent's purchases of stemmed leaf tobacco covering the period from January 1, 1986 to June 30, 1989. The demand letter was essentially based on Sec. 141(b) of the National Internal Revenue's interpretation that:
> "Sec. 141 of the Code provides that there should be collected a tax of P0.75 on each kilogram of the following products of tobacco;
>
> "(b) tobacco prepared or partially prepared with or without the use of any machine or instrument or without being pressed or sweetened. Stemmed leaf tobacco is partially-prepared tobacco as provided under Section 1(L) of Revenue Regulations No. 17-67.
>
> "Further, under the penultimate paragraph of the same section, it provides that fine-cut shorts and refurse, scraps, clipping, stems and sweepings of tobacco resulting from handling and stripping of whole leaf tobacco may be transferred, disposed of or otherwise, sold, without the prepayment of the specific tax when the same are to be used in the manufacture of other tobacco products on which the excise tax will eventually be paid on the finished product. It will be noted from the above enumeration, however, that stemmed leaf tobacco is not among the products exempted from the payment of tax." (idem supra), (underscoring supplied)

"On January 12, 1990, Respondent wrote Petitioner a letter protesting the aforementioned deficiency assessment and requesting the reconsideration and withdrawal of said assessment. In the same letter, Respondent stressed that the BIR assessment was based solely on Section 141(b) of the NIRC without, however, applying Section 137 thereof, the more specific provision which expressly allows the sale of stemmed leaf tobacco as raw material by one manufacturer directly to another without payment of the (excise) tax considering that Respondent purchased stemmed leaf tobacco from manufacturers. Additionally, Respondent made reference to a BIR Ruling dated December 12, 1972, wherein the BIR expressly ruled that, under Section 137 of the NIRC, the sale of partially

manufactured tobacco from a wholesale leaf tobacco dealer (L-3R) to a manufacturer of tobacco products (L-71/2) for use in the manufacture of cigar and cigarettes may also be allowed without prepayment of the tax.

"On November 26, 1990, Respondent received a letter from Petitioner dated August 31, 1990 denying Respondent's protest on the grounds, inter alia, that:

> "In Support of your contention you cited BIR Ruling dated 12 December 1972 wherein it was held that `x x x the subsequent sale or transfer by the L-6/L-3R permittee of the redried or reprocessed product to another L-6 permittee for export or to an L-71/2 for use in the manufacture of cigars or cigarettes may also be allowed without the prepayment of specific tax.'
>
> "Clearly from the aforequoted ruling, the transfer or sale of partially manufactured tobacco, as a rule, is subject to specific tax unless there is an express grant of exemption from the payment of tax. The tax-payers up to this point in time have not presented any authority issued by the BIR granting them exemption."

"On November 26, 1990, Respondent likewise received another letter from the Petitioner dated October 17, 1990 denying Respondent's protest with finality and reiterating the demand to pay the amount of P2,785,338.75, representing deficiency specific tax, exclusive of increments, computed as follows, to wit:

> STEMMED LEAF TOBACCO
>
> RATE OF TAX
>
> SPECIFIC TAX
>
> Local 3,713.785 kls.
>
> 0.75
>
> P2,785,338.75

"On December 6, 1990, Respondent filed with the Court of Tax Appeals a "Petition for Review" seeking for the annulment of the deficiency assessment.

"On August 31, 1995, the Tax Court a quo rendered its Decision, the decretal portion of which reads, to wit:

> "WHEREFORE, in all the foregoing, the assessment of alleged deficiency specific tax in the amount of P2,785,338.75 issued by the Respondent is hereby CANCELLED for lack of merit.
>
> "SO ORDERED." (at page 33, Rollo)

"On September 22, 1995, Respondent filed a Motion for Reconsideration of the aforesaid decision, but the same was denied in a Resolution of the Tax Court a quo, dated May 7, 1996."[2]

On June 10, 1998, petitioner filed with the Court of Appeals a petition for review of the decision of the Court of Tax Appeals.[3]

On September 28, 2000, the Court of Appeals promulgated a decision denying the petition and affirming the decision of the Court of Tax Appeals.[4]

Hence, this appeal.[5]

The Issue

The issue raised is whether respondent is liable for deficiency specific tax under Section 141(b) of the Tax Code in the amount of P2,785,338.75 on purchases of stemmed leaf tobacco for the period January 1, 1986 to June 30,

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1989.

The Court's Ruling

We reverse the decision of the Court of Appeals.

Section 137 (now Sec. 140)[6] of the Tax Code reads in part:

> "SECTION 137. Removal 0f Tobacco products without prepayment of tax. - Products of tobacco entirely unfit for chewing or smoking may be removed free of tax for agricultural or industrial use, under such conditions as may be prescribed in the regulations of the Department of Finance. Stemmed leaf tobacco, fine-cut shorts, the refuse of fine-cut chewing tobacco, scraps, cuttings, clippings, stems or midribs, and sweeping of tobacco may be sold in bulk as raw material by one manufacturer directly to another, without payment of the tax under such conditions as may be prescribed in the regulations of the Department of Finance.
>
> "Stemmed leaf tobacco," as herein used means leaf tobacco which has had the stem or midrib removed. The term does not include broken leaf tobacco."

Thus, the conditions under which stemmed leaf tobacco may be transferred from one factory to another without prepayment of specific tax are as follows:

(a)

The transfer shall be under an official L-7 invoice on which shall be entered the exact weight of the tobacco at the time of its removal.

(b)

Entry shall be made in the L-7 register in the place provided on the page removals.

(c)

Corresponding debit entry shall be made in the L-7 register book of the factory receiving the tobacco under the heading "Refuse, etc., received from the other factory," showing the date of receipt, assessment and invoice numbers, name and address of the consignor, form in which received, and the weight of the tobacco.

Parenthetically, under Revenue Regulations No. 17-67, otherwise known as "Tobacco Regulations on Leaf, Scrap, Other Partially Manufactured Tobacco and Other Tobacco Products; Grading, Classification, Inspection, Shipments, Exportation, Importation and the Manufacture thereof under the provisions of Act No. 2613, as amended," leaf tobacco dealers and manufacturers of tobacco products are administratively designated as follows:

> "CHAPTER I
> ADMINISTRATIVE DESIGNATION, SCHEDULES,
> PARAGRAPH AND ASSESSMENT NUMBER
>
> xxx xxx xxx
>
> Section 3.
>
> (a)
>
> L-3 - Wholesale leaf tobacco dealer.
>
> (b)
>
> L-3F - Wholesale leaf tobacco dealer. Issued only in favor of Farmer's Cooperative Marketing Association (FaCoMas) duly organized in accordance with law.

xxx xxx xxx

(c)

L-3R - Wholesale leaf tobacco dealers. Issued only in favor of persons or entities having fully equipped Redrying Plants.

(d)

L-3 ¼ - Buyers for wholesale leaf of tobacco dealers.

(e)

L-4 - Wholesale leaf tobacco dealers. Issued only in favor of persons or entities having flue-curing barns, who may purchase or receive green Virginia Leaf Tobacco from bona fide tobacco planters only, or handle green leaf of their own production, which tobacco shall be sold or transferred only to holders of L-3 and L-3R permits after fluecuring the tobacco.

(f)

L-5 - Tobacco planters selling to consumers part or the whole of their tobacco productions.

(g)

L-6 - Wholesale leaf tobacco dealers who, exclusively for export, except as otherwise provided for in these regulations perform the following functions:

(1)

Handstripped and/or thresh whole leaf tobacco for themselves or for other L-6 or L-7 permittees;

(2)

Re-process partially manufactured tobacco for themselves, or for other L-6 or L-7 permittees;

(3)

Sell their partially manufactured tobacco to other L-6 permittees;

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(h)

L-7 - Manufacturers of tobacco products. (L-7 ¼ designates all auxiliary registered book [bale books], for manufacturers of tobacco products)

(i)

B-14 - Wholesale leaf tobacco dealers (Privilege tax receipt).

(j)

B-14(a) - Retail leaf tobacco dealers (Privilege tax receipt). (Underscoring ours)

Thus, under Sec. 3(h) of Revenue Regulations No. 17-67, L-7 refers to "Manufacturers of tobacco products." Hence, the transferor of the stemmed leaf tobacco must be an L-7 tobacco manufacturer. This is so because obviously only an L-7 tobacco manufacturer has an official L-7 invoice and an L-7 register and the transferee of the stemmed leaf tobacco must also be an L-7 tobacco manufacturer because, to repeat, only an L-7 tobacco manufacturer has an L-7 registry book.

In the case at bar, the stemmed leaf tobacco purchased by respondent came from Tobacco Industries of the Philippines, NGC Trading and Philippine Tobacco Fluecuring Corporation, who are all L-6 permittees.

Section 137 (now 140) of the Tax Code qualifies the term "manufacturer" by the phrase "under such conditions as may be prescribed in the regulations of the Department of Finance." Under such regulations the term "manufacturer" refers only to L-7.

We agree with the petitioner that the exemption from specific tax of the sale of stemmed leaf tobacco as raw material by one L-7 directly to another L-7 is because such stemmed leaf tobacco has been subjected to specific tax when an L-7 manufacturer purchased the same from wholesale leaf tobacco dealers designated under Section 3, Chapter I, Revenue Regulations No. 17-67 (supra) as L-3, L-3F, L-3R, L-4, or L-6, the latter being also a stripper of leaf tobacco. These are the sources of stemmed leaf tobacco to be used as raw materials by an L-7 manufacturer which does not produce stemmed leaf tobacco. When an L-7 manufacturer sells the stemmed leaf tobacco purchased from the foregoing suppliers to another L-7 manufacturer as raw material, such sale is not subject to specific tax under Section 137 (now Section 140), as implemented by Section 20(a) of Revenue Regulations No. V-39.

Consequently, respondent's purchases of stemmed leaf tobacco were not exempt from specific tax.

The Fallo

WHEREFORE, the Court REVERSES the decision of the Court of Appeals and the Court of Tax Appeals. The Court orders respondent to pay the amount of P2,785,338.75, as deficiency specific tax on purchases of stemmed leaf tobacco for the period January 1, 1986 to June 30, 1989, plus penalties incident to delinquency pursuant to Sections 248 and 249 of the Tax Code.

No costs.

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SO ORDERED.

Davide, Jr., C.J., (Chairman), Puno, Kapunan, and Ynares-Santiago, JJ., concur.

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[1] In CA-G. R. SP No. 40773, promulgated on September 28, 2000. Callejo, Sr., J., ponente, Reyes, and Villarama, Jr., JJ., concurring.

[2] Petition, Annex "A", Rollo, pp. 23-34, at pp. 23-25.

[3] Petition, CA Rollo, pp. 8-62.

[4] Petition, Annex "A", Rollo, pp. 23-34.

[5] Petition filed on November 20, 2000, Rollo, pp. 8-22.

[6] The National Internal Revenue Code of 1997.

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