

ORIENTAL KAPOK INDUSTRIES, PETITIONER, VS. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

G. R. No. 17837. January 31, 1963

Ponente: BARRERA, J.

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BARRERA, J.:

This is an appeal taken by petitioner Oriental Kapok Industries from the decision of the Court of Tax Appeals (in C.T.A. Case No. 506) affirming the decision of respondent Commissioner of Internal Revenue denying petitioner's claim for refund of P3,212.69 paid as sales tax for 1956, under Section 186 of the National Internal Revenue Code, as amended.

It appears that petitioner, a duly organized partnership, is engaged in the business of buying unhusked kapok and processing the same to produce clean, light and fluffy kapok which is later sold to manufacturers of mattresses, pillows, and cushions. The processing is done in the following manner:

"(1) MACHINERY USED—The machinery used in the processing of the kapok fibers by the Oriental Kapok Industries, Cebu City, is a locally made contraption, consisting: of a horizontal cylinder divided lengthwise into two compartments by a wire netting. The upper compartment (marked as Chamber A in the enclosed diagram) housed a revolving shaft running lengthwise thru the middle of the said compartment, in which sets of blades or paddles are attached a few apart. This revolving shaft functions by means of a series of pulleys and belts attachment powered by a 50-horse-power diesel engine. Above this cylinder is a wooden platform coming from the storage room of the raw kapok. The raw kapok passes on this platform and enters Chamber A of the cylinder thru the opening at the right upper end. Once the raw kapok is inside Chamber A it is beaten by the blades or paddles. In this process, the seeds and the broken cores are loosened and fall down thru the wire netting to Chamber B, which is the lower compartment of the cylinder. At the right end of Chamber B, a blower is installed, which blows the loosened kapok fibers thru a piping to another room, which is marked as Chamber X in the enclosed diagram. The kapok fiber blown to Chamber X is the finished product which is to be packed in the bags for the market. The machine is called by the Management as the 'SEPARATOR'.

"(2) CHEMICAL AND/OR INGREDIENTS USED—No chemicals and/or ingredients are used before, during, and after the cleaning process. The raw kapok with seeds and cores but without husks or skins, is first aired in the yard of the compound inclosed by wire nettings. After a day or two, it is then fed to the 'separator' machine thru the entrance in the wooden platform.

"(3) PURIFYING OR REFINING PROCESS—In the particular machine used by the Oriental Kapok Industries, Cebu City, there is only one chamber equipped with a shaft wherein sets of blades or paddles are attached. The raw kapok which is fed thru an opening is being beaten by the rotating blades, loosening the fibers, seeds and cores in so doing. The seeds and broken cores fall to the lower chamber, where they are collected for other uses. It should be noted that this mechanized process evolved from the primitive form of separating the seeds from the kapok fibers for household use, which is by placing the kapok fibers, devoid of husks or skins, in a cylindrical bamboo basket and rotating a small bamboo stick sliced into several places at the Lower extremity, by rolling the said stick with the pressed palms of both hands, within the basket. The 'separator' machine used

by Oriental Kapok Industries, is simply constructed along the above-mentioned principle, except for the blower installed to blow the light fibers thru the piping to the depositing chamber.

"(4) CHANGES EFFECTED ON THE FINISHED PRODUCTS, AS COMPARED WITH THE RAW MATERIAL.—The raw material is the dry, not-thoroughly-unloosened fiber with seeds, cores, and a few sprinkling of foreign matters. The finished product is the light, loose, and fluffy fibers cleaned of seeds, cores, and other foreign matters. No apparent change in the color can be detected." (Exh. 3, pp. 60-61, BIR. Records.)

On its sales of processed kapok fiber, petitioner paid the total sum of P7,246.89 as 7% sales tax imposed under Section 186 of the Tax Code, corresponding to the period from the first quarter of 1955 to November, 1956.

Contending that it is not a manufacturer of kapok fiber, petitioner filed with respondent a claim for refund of said sum paid as sales tax. The claim for refund was denied by respondent in his letter of October 4, 1957. Petitioner moved for reconsideration in his letter of November 14, but the same was denied by respondent in his letter of January 31, 1958.

On February 21, 1958, petitioner filed a petition for review with the Court of Tax Appeals. In said court, respondent asserted that petitioner's claim for refund of the sum of P4,034.20 as sales tax for 1955 had already prescribed. Petitioner admitted the prescription of said claim and, therefore, limited its claim for refund to the sum of P3,212.69 paid as sales tax for the first quarter of 1956 to November, 1956.

On November 12, 1960, the Court of Tax Appeals affirmed the decision of respondent, partly stating:

"In *Cosmos Kapok Factory vs. Araneta*, C.T.A. No. 125, March 29, 1957, and *Pacific Kapok Factory, C.T.A. No. 342*, June 29, 1959, it was held that the processing of raw kapok into clean kapok fiber by means of a machine constitutes manufacturing, and the manufacturer is subject to the sales tax on his sales of kapok fiber prescribed in Section 186 of the Revenue Code. We quote:

'In *Cosmos Kapok Factory vs. Araneta*, C.T.A. No. 125, March 29, 1957, wherein the facts are the same as in the instant case, it was held that—

"* * * petitioner falls squarely under the second classification mentioned in Section 194(x) of the Tax Code, viz: 'any one who by any such (physical or chemical) process alters the quality of any such raw materials or manufactured or partially manufactured product, so as to reduce it to marketable shape, or prepare it for any of the uses of Industry.' * * *

"The above described process, clearly indicates that the kapok is sufficiently changed by means of machinery, such that a thick and tough raw kapok is transformed into a cleaned and light kapok, thereby altering its quality, so as to reduce it to marketable shape, or prepare it for any of the uses of industry and thus become a distinct class of merchandise (see *Ngo Siek vs. Collector*, 52 Off. Gaz., 6873). We are, therefore, of the opinion, and so hold, that petitioner is a manufacturer as defined in Section 194 (x) of the National Internal Revenue Code and, as such, liable for the 7% tax on its sales of processed kapok prescribed by Section 180 thereof."

"The records do not reveal anything which would justify reversal of our opinion in the case of *Cosmos Kapok Factory* cited above. It is, however, argued that kapok being an agricultural product, petitioner is exempt from the sales tax on its sales of kapok, pursuant to Section 188(b) of the Revenue Code. Section 188 (b) exempts from the sales tax, agricultural products, when, they are sold, bartered, or exchanged in this country by the producer or owner of the land where produced. But petitioner is neither the producer of the kapok, nor the owner of the land where it was produced. It merely purchased the kapok which it processed and later sold. Therefore, Section 188 (b) does not apply to petitioner. (*Pacific Kapok Factory vs. Araneta*, C.T.A. No. 342 June 29, 1959.)

"In line with, our opinion in the cases cited above, the decision appealed from is affirmed. With costs against

petitioner.

"So ordered."

From this decision, petitioner appealed to us.

The sole issue for determination in this case is whether petitioner is a "manufacturer" of kapok and, therefore, liable to pay the 7% sales tax imposed under Section 186 of the tax Code.[1]

Section 194 (x) of the Tax Code defines the term "manufacturer" as follows:

" (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 product in such manner as to prepare it for a speeded use or uses to which it would not have been put in its, original condition, or 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 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 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." (Italics supplied.)

Petitioner, to our mind, is a manufacturer as denied in the above-quoted provision of the Tax Code. The Court of Tax Appeals found as a fact that petitioner buys unhusked kapok, that is, kapok with skins or husks or kapok pods. Then the pod is broken and the skin is removed. Thereafter the raw kapok fiber with seeds and cores is aired in the yard of the compound. After a day or two, the kapok is fed into a machine, called "separator" and processed in the manner described above. It is therefore clear that the physical process employed by petitioner from the time it buys the unhusked kapok pods until it obtains the processed product, through the use of a machine, known as the "separator", not only alters the exterior texture or form of the raw unhusked kapok pods, but also the quality of the kapok fiber itself from its original state of "dry, not-thoroughly-unloosened fiber with seeds, cores, and a few sprinkling of foreign matters", into one which is "light, loose, and fluffy, cleaned of seeds, cores, and other foreign matters", so as to reduce it to marketable shape or prepare it for any of the uses of industry, such as the stuffing of mattresses, pillows and cushions. The finished product is certainly and essentially different from the raw unhusked kapok pods that petitioner buys, and is a distinct class of merchandise with qualities and uses all its own. Hence, even granting, *arguendo*, that the process employed does not amount to manufacturing as ordinarily understood, still it involves production of the finished article which makes the petitioner a "producer" whose sales of its product are taxable under said Section 186 of the Tax Code. (*Ngo Siek vs. Collector of Internal Revenue*, L-8989, October 18, 1956 , 52 Off. Gaz., 6873.)

Petitioner, however; argues that since kapok is an agricultural product, it is exempt from the sales tax in question, pursuant to Section 188(b) of the Tax Code.[2] But, as the trial court correctly pointed out, petitioner is neither the producer of the raw kapok, nor the owner of the land where it is produced. It merely purchased the kapok which it processed and later sold. Consequently, it may not invoke, or be entitled to the tax exemption provided in said section. (See *Ngo Siek vs. Collector of Internal Revenue*, *supra*)

With these conclusions, there is no need to discuss the other points raised by petitioner in its brief.

Wherefore, finding no error in the appealed decision of the Tax Court, the same is hereby affirmed, with costs against the petitioner. It is so ordered.

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

Labrador, J., I reserved my vote.

[1] Sec. 186. Percentage tax on sales of other articles.—There shall be levied, assessed and collected once only on every original sale, barter, exchange, and similar transaction either for nominal or valuable considerations, intended to transfer ownership of, or title to, the article's not enumerated in sections one hundred and eighty-four and one hundred and eighty-five a tax equivalent to seven per centum of the gross selling price or gross value in money of the article so sold, bartered, exchanged or transferred, such tax to be paid by the manufacturer or producer. * * *."

[2] SEC. 188. Transactions and persons not subject to percentage tax.—In computing the tax imposed in sections one hundred eighty-four, one hundred eighty-five, and one hundred eighty-six, transactions in the following commodities shall be excluded: * * *

“(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, * * *.”

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