

COMMISSIONER OF INTERNAL REVENUE, PETITIONER VS. ARNOLDUS CARPENTRY SHOP, INC. AND COURT OF TAX APPEALS, RESPONDENTS.

G.R. No. 71122, March 25, 1988

Ponente: CORTES, J.

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CORTES, J.:

Assailed in this petition is the decision of the Court of Tax Appeals in CTA case No. 3357 entitled "ARNOLDUS CARPENTRY SHOP, INC. v. COMMISSIONER OF INTERNAL REVENUE".

The facts are simple.

Arnoldus Carpentry Shop, Inc. (private respondent herein) is a domestic corporation which has been in existence since 1960. It has for its secondary purpose the "preparing, processing, buying, selling, exporting, importing, manufacturing, trading and dealing in cabinet shop products, wood and metal home and office furniture, cabinets, doors/windows, etc., including their component parts and materials, of any and all nature and description" (Rollo, pp. 160-161). These furniture, cabinets and other woodwork were sold locally and exported abroad.

For this business venture, private respondent kept samples or models of its woodwork on display from where its customers may refer to when placing their orders.

Sometime in March 1979, the examiners of the petitioner Commissioner of Internal Revenue conducted an investigation of the business tax liabilities of private respondent pursuant to Letter of Authority No. 08307 NA dated November 23, 1978. As per the examination, the total gross sales of private respondent for the year 1977 from both its local and foreign dealings amounted to P5,162,787.59 (Rollo, p. 60). From this amount, private respondent reported in its quarterly percentage tax returns P2,471,981.62 for its gross local sales. The balance of P2,690,805.97, which is 52% of the total gross sales, was considered as its gross export sales (CTA Decision, p. 12).

Based on such an examination, BIR examiners Honesto A. Vergel de Dios and Voltaire Trinidad made a report to the Commissioner classifying private respondent as an "other independent contractor"-under Sec. 205 (16) [now Sec. 169 (q)] of the Tax Code. The relevant portion of the report reads:

Examination of the records show that per purchase orders, which are hereby attached, of the taxpayer's customers during the period under review, subject corporation should be considered a contractor and not a manufacturer. The corporation 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, {Luzon Stevedoring Co. v. Trinidad, 43 Phil. 803. Hence, in the computation of the percentage tax, the 3% contractor's tax should be imposed instead of the 7% manufacturer's tax. [Rollo, p. 59] (Italics supplied.)

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As a result thereof, the examiners assessed private respondent for deficiency tax in the amount of EIGHTY

EIGHT THOUSAND NINE HUNDRED SEVENTY TWO PESOS AND TWENTY THREE CENTAVOS (P88,972.23). Later, on January 31, 1981, private respondent received a letter/notice of tax deficiency assessment inclusive of charges and interest for the year 1977 in the amount of ONE HUNDRED EIGHT THOUSAND SEVEN HUNDRED TWENTY PESOS AND NINETY TWO CENTAVOS (P108,720.92). This tax deficiency was a consequence of the 3% tax imposed on private respondent's gross export sales which, in turn, resulted from the examiners' finding that categorized private respondent as a contractor (CTA decision, p. 2).

Against this assessment, private respondent filed on February 19, 1981 a protest with the petitioner Commissioner of Internal Revenue. In the protest letter, private respondent's manager maintained that the carpentry shop is a manufacturer and therefor entitled to tax exemption on its gross export sales under Section 202 (e) of the National Internal Revenue Code. He explained that it was the 7% tax exemption on export sales which prompted private respondent to exploit the foreign market which resulted in the increase of its foreign sales to at least 52% of its total gross sales in 1977 (CTA decision, pp. 12-13).

On June 23, 1981, private respondent received the final decision of the petitioner stating:

It is the stand of this Office that you are considered a contractor and not a manufacturer. Records show that you manufacture woodworks only upon previous order from supposed manufacturers and only in accordance with the latter's own design, model number, color, etc. [Rollo, p. 64] (*Italics supplied.*)

On July 22, 1981, private respondent appealed to the Court of Tax Appeals alleging that the decision of the Commissioner was contrary to law and the facts of the case.

On April 22, 1985, respondent Court of Tax Appeals rendered the questioned decision holding that private respondent was a manufacturer thereby reversing the decision of the petitioner.

Hence, this petition for review wherein petitioner raises the sole issue of: Whether or not the Court of Tax Appeals erred in holding that private respondent is a manufacturer and not a contractor and therefore not liable for the amount of P108,720.92, as deficiency contractor's tax, inclusive of surcharge and interest, for the year 1977.

The petition is without merit.

1. Private respondent is a "manufacturer" as defined in the Tax Code and not a "contractor" under Section 205(e) of the Tax Code as petitioner would have this Court decide.

(a) Section 205 (16) [now Sec. 170 (q)] of the Tax Code defines "independent contractors as:

persons (juridical and natural) not enumerated above (but not including individuals subject to the occupation tax under Section 12 of the Local Tax Code) whose activity consists essentially of the sale of all kinds of services for a fee regardless of whether or not the performance of the service calls for the exercise or use of the physical or mental faculties of such contractors or their employees. (*Italics supplied.*)

Private respondent's business does not fall under this definition.

Petitioner contends that the fact that private respondent "designs and makes samples or models that are 'displayed' or presented or 'submitted' to prospective buyers who 'might choose' therefrom" signifies that what private respondent is selling is a kind of service its shop is capable of rendering in terms of woodwork skills and craftsmanship (Brief for Petitioner, p. 6). He further stresses the point that if there are no orders placed for goods as represented by the sample or model, the shop does not produce anything; on the other hand, if there are orders placed, the shop goes into full production to fill up the quantity ordered (Petitioner's Brief, p. 7).

The facts of the case do not support petitioner's claim. Petitioner is ignoring the fact that private respondent sells

goods which it keeps in stock and not services. As the respondent Tax Court had found:

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Petitioner [private respondent herein] claims, and the records bear petitioner out, that it had a ready stock of its shop products for sale to its foreign and local buyers. As a matter of fact, the purchase orders from its foreign buyers showed that they are ordered by referring to the models designated by petitioner. Even purchases by local buyers for television cabinets (Exhs. "2" to "13", pp. 1-13, BIR records) were by orders for existing models, except only for some adjustments in sizes and accessories utilized.

With regard to the television cabinets, petitioner presented three witnesses — its bookkeeper, production manager and manager who testified that samples of television cabinets were designed and made by petitioner, from which models the television companies such as Hitachi, National and others might choose, then specified whatever innovations they desired. If found to be saleable, some television cabinets were manufactured for display and sold to the general public. These cabinets were not exported but only sold locally, (t.s.n. pp 22-35, February 18, 1982; t.s.n. pp. 7-10, March 25, 1982; t.s.n., pp. 3-6, August 10, 1983.)

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In the case of petitioner's other woodwork products such as barometer cases, knife racks, church furniture, school furniture, knock down chairs, etc., petitioner's above-mentioned witnesses testified that these were manufactured without previous orders. Samples were displayed, and if in stock, were available for immediate sale to local and foreign customers. Such testimony was not contradicted by respondent (petitioner herein). And in all the purchase orders presented as exhibits, whether from foreign or local buyers, reference was made to the model number of the product being ordered or to the sample submitted by petitioner.

Respondent's examiners, in their memorandum to the Commissioner of Internal Revenue, stated that petitioner manufactured only upon previous orders from customers and "only in accordance with the latter's own design, model number, color, etc." (Exh. "1", p. 27, BIR records.) Their bare statement that the model numbers and designs were the customer's own, unaccompanied by adequate evidence, is difficult to believe. It ignores commonly accepted and recognized business practices that it is not the customer but the manufacturer who furnishes the samples or models from which the customers select when placing their orders. The evidence adduced by petitioner to prove that the model numbers and designs were its own is more convincing. [CTA decision, pp. 6-8.] (Italics supplied.)

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This Court finds no reason to disagree with the Tax Court's findings of fact. It has been consistently held that while the decisions of the Court of Tax Appeals are appealable to the Supreme Court, the former's findings of fact are entitled to the highest respect. The factual findings can only be disturbed on appeal if not supported by substantial evidence or if there has been a showing of gross error or abuse on the part of the tax court [Collector of Internal Revenue v. Henderson, L-12954, February 28, 1961, 1 SCRA 649; Aznar v. Court of Tax Appeals, L-20569, Aug. 23, 1974, 58 SCRA 519; Raymundo v. deJoya, L-27733, Dec. 3, 1980, 101 SCRA 495; Industrial Textiles Manufacturing Co. of the Phils., Inc. v. Commissioner of Internal Revenue, L-27718 and L-27768, May 27, 1985, 136 SCRA 549.]

(b) Neither can Article 1467 of the New Civil Code help petitioner's cause. Article 1467 states:

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.

Petitioner alleged that what exists prior to any order is but the sample model only, nothing more, nothing less and

the ordered quantity would never have come into existence but for the particular order as represented by the sample or model [Brief for Petitioner, pp. 9-10].

Petitioner wants to impress upon this Court that under Article 1467, the true test of whether or not the contract is a piece of work (and thus classifying private respondent as a contractor) or a contract of sale (which would classify private respondent as a manufacturer) is the mere existence of the product at the time of the perfection of the contract such that if the thing already exists, the contract is of sale, if not, it is work.

This is not the test followed in this jurisdiction. As can be clearly seen from the wordings of Art. 1467, what determines whether the contract is one of work or of sale is whether the thing has been "manufactured specially for the customer and upon his special order." Thus, if the thing is specially done at the order of another, this is a contract for a piece of work. If, on the other hand, the thing is manufactured or procured for the general market in the ordinary course of one's business, it is a contract of sale.

Jurisprudence has followed this criterion. As held in *Commissioner of Internal Revenue v. Engineering Equipment and Supply Co.* (L-27044 and L-27452, June 30, 1975, 64 SCRA 590, 597), "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." (Italics supplied.) And in a BIR ruling, which as per Sec. 326 (now Sec. 277) of the Tax Court the Commissioner has the power to make and which, as per settled jurisprudence is entitled to the greatest weight as an administrative view [*National Federation of Sugar Workers (NFSW) v. Ovejera*, G.R. No. 59743, May 31, 1982, 114 SCRA 354, 391; *Sierra Madre Trust v. Hon. Sec. of Agriculture and Natural Resources*, Nos. L-32370 and L-32767, April 20, 1983, 121 SCRA 384; *Espanol v. Chairman and Members of the Board of Administrators, Phil. Veterans Administration*, L-44616, June 29, 1985, 137 SCRA 314], "one who has ready for the sale to the general public finished furniture is a manufacturer, and the mere fact that he did not have on hand a particular piece or pieces of furniture ordered does not make him a contractor only" (BIR Ruling No. 537, series of 1960). Likewise,

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When the vendor enters into a contract for the delivery of an article which in the ordinary course of his business he manufactures or procures for the general market at a price certain (Art. 1458) such contract is one of sale even if at the time of contracting he may not have such article on hand. Such articles fall within the meaning of "future goods" mentioned in Art. 1462, par. 1. [5 Padilla. Civil Law: Civil Code Annotated 139 (1974)].

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These considerations were what precisely moved the respondent Court of Tax Appeals to rule that "the fact that [private respondent] kept models of its products . . . indicate that these products were for sale to the general public and not for special orders," citing *Celestino Co and Co. v. Collector of Internal Revenue* [99 Phil. 841 (1956)]. (CTA, Decision, pp. 8-9.)

Petitioner alleges that the error of the respondent Tax Court was due to the "heavy albeit misplaced and indiscriminate reliance on the case of *Celestino Co and Co. v. Collector of Internal Revenue* [99 Phil. 841, 842 (1956)] which is not a case in point" (Brief for Petitioner, pp. 14-15). The Commissioner of Internal Revenue made capital of the difference between the kinds of business establishments involved — a FACTORY in the *Celestino Co* case and a CARPENTRY SHOP in this case (Brief for Petitioner, pp. 14-18). Petitioner seems to have missed the whole point in the former case.

True, the former case did mention the fact of the business concern being a FACTORY. Thus:

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... I cannot believe that petitioner company would take, as in fact it has taken, all the trouble and expense of registering a special trade name for its sash business and then orders company stationery carrying the bold print 'Oriental Sash Factory (Celestino Co and Company, Prop.) 926 Raon St., Quiapo, Manila, Tel. No. 33076, Manufacturers of all kinds of doors, windows, sashes, furniture, etc. used season-dried and kiln-dried lumber, of the best quality workmanship' solely for the purpose of supplying the need for doors, windows and sash of its special and limited customers. One will note that petitioner has chosen for its trade name and has offered itself to the public as a FACTORY, which means it is out to do business in its chosen lines on a big scale. 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. [Italics supplied.]

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However, these findings were merely attendant facts to show what the Court was really driving at — the habituality of the production of the goods involved for the general public.

In the instant case, it may be that what is involved is a CARPENTRY SHOP. But, in the same vein, there are also attendant facts herein to show habituality of the production for the general public.

In this wise, it is noteworthy to again cite the findings of fact of the respondent Tax Court:

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Petitioner [private respondent herein] claims, and the records bear petitioner out, that it had a ready stock of its shop products for sale to its foreign and local buyers. As a matter of fact, the purchase orders from its foreign buyers showed that they ordered by referring to the models designed by petitioner. Even purchases by local buyers for television cabinets ... were by orders for existing models . . .

With regard to the television cabinets, petitioner presented three witnesses . . . who testified that samples of television cabinets were designed and made by petitioner, from which models the television companies . . . might choose, then specified whatever innovations they desired. If found to be saleable, some television cabinets were manufactured for display and sold to the general public.

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In the case of petitioner's other woodwork products . . . these were manufactured without previous orders. Samples were displayed, and if in stock, were available for immediate sale to local and foreign customers. [CTA decision, pp. 6-8.] [Italics supplied.]

(c) The private respondent not being a "contractor" as defined by the Tax Code or of the New Civil Code, is it a "manufacturer" as countered by the carpentry shop?

Sec. 187 (x) [now Sec. 157 (x)] of the Tax Code defines a "manufacturer" as follows:

"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 special use or uses to which it could not have been in its original condition, or who by any such process alters the quality or 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 different kinds and in such manner that the finished product of such process or 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 would 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.

It is a basic rule in statutory construction that when the language of the law is clear and unequivocal, the law must be taken to mean exactly what it says [Banawa et al. v. Mirano et al., L-24750, May 16, 1980, 97 SCRA 517, 533].

The term "manufacturer" had been considered in its ordinary and general usage. The term has been construed broadly to include such processes as buying and converting duck eggs to salted eggs {"balut") [Ngo Shiekv. Collector of Internal Revenue, 100 Phil. 60 (1956)]; the processing of unhusked kapok into clean kapok fiber [Oriental Kapok Industries v. Commissioner of Internal Revenue, L-17837, Jan. 31, 1963, 7 SCRA 132]; or making charcoal out of firewood [Bermejo v. Collector of Internal Revenue, 87 Phil. 96 (1950)].

2. As the Court of Tax Appeals did not err in holding that private respondent is a "manufacturer," then private respondent is entitled to the tax exemption under Sec. 202 (d) and (e) [now Sec. 167 (d) and (e)] of the Tax Code which states:

Sec. 202. Articles not subject to percentage tax on sales.— The following shall be exempt from the percentage taxes imposed in Sections 194, 195, 196, 197, 198, 199, and 201:

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(d) Articles shipped or exported by the manufacturer or producer, irrespective of any shipping arrangement that may be agreed upon which may influence or determine the transfer of ownership of the articles so exported.

(e) Articles sold by "registered export producers" to (1) other "registered export producers" (2) "registered export traders" or (3) foreign tourists or travelers, which are considered as "export sales."

The law is clear on this point. It is conceded that as a rule, as argued by petitioner, any claim for tax exemption from tax statutes is strictly construed against the taxpayer and it is contingent upon private respondent as taxpayer to establish a clear right to tax exemption [Brief for Petitioners, p. 18]. Tax exemptions are strictly construed against the grantee and liberally in favor of the taxing authority [City of Baguio v. Busuego, L-29772, Sept. 18, 1980, 100 SCRA 116]; they are looked upon with disfavor [Western Minolco Corp. v. Commissioner of Internal Revenue, G.R. No. 61632, Aug. 16, 1983, 124 SCRA 121]. They are held strictly against the taxpayer and if not expressly mentioned in the law, must at least be within its purview by clear legislative intent [Commissioner of Customs v. Phil. Acetylene Co., L-22443, May 29, 1971, 39 SCRA 70; Davao Light and Power Co. v. Commissioner of Customs, (G.R. Nos. L-28739 and L-28902, March 29, 1972, 44 SCRA 122].

Conversely, therefore, if there is an express mention or if the taxpayer falls within the purview of the exemption by clear legislative intent, then the rule on strict construction will not apply. In the present case the respondent Tax Court did not err in classifying private respondent as a "manufacturer." Clearly, the latter falls with the term "manufacturer" mentioned in Art. 202 (d) and (e) of the Tax Code. As the only question raised by petitioner in relation to this tax exemption claim by private respondent is the classification of the latter as a manufacturer, this Court affirms the holding of respondent Tax Court that private respondent is entitled to the percentage tax exemption on its export sales.

There is nothing illegal in taking advantage of tax exemptions. When the private respondent was still exporting less and producing locally more, the petitioner did not question its classification as a manufacturer. But when in 1977 the private respondent produced locally less and exported more, petitioner did a turnabout and imposed the contractor's tax. By classifying the private respondent as a contractor, petitioner would likewise take away the tax

exemptions granted under Sec. 202 for manufacturers. Petitioner's action finds no support in the applicable law.

WHEREFORE, the Court hereby DENIES the petitioner for lack of merit and AFFIRMS the Court of Tax Appeals decision in CTA Case No. 3357.

SO ORDERED.

Fernan (Chairman), Gutierrez, Jr., Feliciano, and Bidin, JJ., concur.

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