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FIRST DIVISION

[G.R. No. L-33425. January 20, 1989]

PROCTER AND GAMBLE PHILIPPINE MANUFACTURING CORPORATION, *petitioner, vs.* **THE COMMISSIONER OF INTERNAL REVENUE and the COURT OF TAX APPEALS,** *respondents.*

SYLLABUS

1. TAXATION; NATIONAL INTERNAL REVENUE CODE; SALES TAX; MARKET VALUE, DEFINED. — As used in the first paragraph of Section 189, "market value" means "*the gross value in money* or the *actual selling price* of the coconut oil at the time they leave the factory or mill warehouse."

2. ID.; ID.; ID.; DEDUCTIBLE "TOTAL COST," CONSTRUED; MILLER'S TAX PAID BY MANUFACTURER FOR COCONUT OIL MANUFACTURED, INCLUDED. — The 2% miller's tax is based *on the market value* of the coconut oil (par. 1, Sec. 189, Tax Code). The 7% sales tax is based on the market value of the manufactured article using coconut oil as a principal ingredient (Sec. 186, Tax Code). Both Sections 186 and 189 of the Tax Code provide that "the total cost" of the material (coconut oil) used in the manufacture of another article is deductible from the gross selling price of the manufactured article. Logically, the "total cost" of such oil would be its *market value plus the 2% miller's tax* that had to be paid before the oil could be used. If the law had intended to deduct only the "market value" of said material, it would have so provided instead of using the term "total cost" which connotes the sum of expenses, costs of production and charges (the 2% miller's tax) that the manufacturer paid for the oil to be able to use it in the manufacture of lard, soap, and margarine.

3. ID.; ID.; ID.; ID.; ID.; REASON BEHIND. — To deny to the petitioner the right to deduct the 2% miller's tax enjoyed by other soap, lard, and margarine manufacturers who, unlike the petitioner, *buy*, instead of *produce*, their raw materials would discourage the establishment of integrated or self-sufficient

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industries. The State would be regressing from, instead of progressing toward, the national goal of self-sufficiency.

APPEARANCES OF COUNSEL

B.V. Arela. M.C. Gutierrez and *Tirso A. Tejada* for petitioner.

D E C I S I O N

GRIÑO-AQUINO, *J.*:

This is a petition for review of the decision of the Court of Tax Appeals dated October 30, 1970, affirming the resolution of the Commissioner of Internal Revenue finding the petitioner liable for deficiency sales tax plus surcharge for the years 1951 up to the first quarter of 1956 in the sum of ₱124,664.60, on its sales of lard, soap and margarine. The issue in this case involves the proper computation of the 7% sales tax under Section 186 of the Internal Revenue Code.

The facts are stated in the decision of the Tax Court as follows:

"Petitioner is a manufacturer of lard, soap and margarine the principal ingredient in the manufacture of which is coconut oil, which is also manufactured by it. The sales tax on sales of lard, soap, and margarine was paid by petitioner pursuant to Section 186 of the National Internal Revenue Code. The tax of 2% on the market value of coconut oil provided in Section 189 was also paid by petitioner. In computing the sales tax on lard, soap and margarine, petitioner deducted from the gross selling price not only the market value of the coconut oil used in the manufacture of said articles but also the tax of 2% which it had previously paid on said oil under Section 189 of the Revenue Code.

"Respondent (Commissioner of Internal Revenue) contends that it was error for petitioner to deduct from the gross selling price of lard, soap, and margarine the amount corresponding to the tax of 2% on the coconut oil paid under Section 189; hence, the deficiency assessment." (p. 17, *Rollo*.)

Petitioner appealed to the Court of Tax Appeals.

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On July 31, 1970, the Tax Court ordered that the case be reset for hearing on September 14, 1970, at 9:00 A.M. to enable the parties to present evidence as to the actual cost of production of the coconut oil used by petitioner in the manufacture of lard, soap, and margarine and sold from 1951 to the first quarter of 1956 (pp. 90-91, CTA Record). However, both parties failed to submit such evidence, and instead, asked that the case be considered submitted on the basis of the pleadings and the evidence already presented.

On October 30, 1970, the Court of Tax Appeals affirmed the ruling of the Revenue Commissioner. The Court was "constrained to hold that, in the instant case, the *total cost* of the coconut oil in question which is deductible from the gross selling price of lard, soap, and margarine manufactured by the petitioner is the *market value* thereof as agreed to by both parties" and as quoted by the Bureau of Commerce at the time of its withdrawal from petitioner's oil mill or factory (p. 20, *Rollo*).

The Tax Court justified the exclusion of the 2% miller's tax from the *total cost* of the coconut oil used in the manufacture of lard, soap, and margarine by the petitioner, as follows:

"It is contended on behalf of petitioner that the total cost of coconut oil used by it in the manufacture of lard, soap and margarine should include the tax it paid because if said oil was purchased by another who uses the oil in the manufacture of the same articles, the said tax would form part of the cost of oil which is deductible from the gross selling price of the manufactured articles. x x x

"x x x x x x x x x

"The above line of reasoning loses sight of the fact that the cost of an article to a purchaser is different from that of the manufacturer. To our mind, the cost of an article to a manufacturer is the total amount incurred or spent in the manufacture of such article; while the cost of the same article to a purchaser is the total amount paid by him to acquire the same. This does not place the manufacturer at any disadvantage as against a purchaser, as alleged by petitioner, because a manufacturer does not sell articles manufactured by it at cost. A manufacturer ordinarily sells articles at cost plus expenses

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and profit. Therefore, the supposed disadvantage to a manufacturer in not being allowed to claim deduction for the tax paid on the raw material is more than compensated by the sale at a profit of such raw materials.

"There is another point worthy of consideration which we believe militates strongly against the position taken by petitioner. The 2% tax on coconut oil paid by it is deductible from its gross income for purposes of the income tax (See Section 30[c], Rev. Code). To permit it to claim deduction for the same amount from the gross selling price of lard, soap, and margarine manufactured by it for purposes of the sales tax would give it a *double advantage*. This to our mind has never been the intention of the law.

"It is to be noted that the law allows deduction of the 'total cost' of coconut oil from the gross selling price of lard, soap, and margarine manufactured by petitioner. What was deducted by petitioner was not the 'total cost' but 'the market value of oil as quoted by the Bureau of Commerce at the time of its withdrawal from petitioner's oil mill or factory and the 2% miller's tax on said oil withdrawn.' *The market value of an article is ordinarily not the equivalent of its cost.* Generally, a manufacturer sells its manufactured articles at market value, which covers not only the cost of manufacture but also the expected profit, except under abnormal conditions when a manufacturer is compelled to sell at cost or below cost. Nothing appears of record to indicate that in this case the market value of coconut oil was only the cost of manufacturing the same." (pp. 18-19, *Rollo*; italics supplied).

Hence, the present petition for review on the grounds that:

"a) Section 186 of the Revenue Code allows deductibility of 'total cost' of raw materials in computing sales tax on manufactured products, and 'total cost' includes all amounts paid to acquire and avail of the use of raw materials, such as the sales of miller's tax thereon.

"b) The disallowance of the deduction of the 2% miller's tax by petitioner amounts to penalizing it for operating its own oil mill — an act inconsistent with the national policy of integrating industries.

"c) Petitioner did not claim the 2% miller's tax as deduction from its gross income." (pp. 4, 9 & 10, *Rollo*).

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The petition for review is meritorious.

Sections 186, 188 and 189 of the Internal Revenue Code of 1939 provide as follows:

"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 articles not enumerated in sections one hundred and eighty-four, one hundred and eighty-five, one hundred and eighty-five-A, and one hundred and eighty-five-B, a tax equivalent to seven *per centum* of the gross selling price or gross value in money of the articles so sold, bartered, exchanged, or transferred, such tax to be paid by the manufacturer, or producer: *Provided*, That *where the articles subject to tax under this section are manufactured out of materials likewise subject to tax under this section and section one hundred and eighty-nine, 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*." (Italics supplied).

"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:

"(a) Articles subject to tax under Title IV of this Code.

xxx xxx xxx

"(d) Articles subject to tax under section one hundred eighty-nine of this Code."

"SEC. 189. *Percentage tax upon processors of pineapple, proprietors or operators of rope factories, sugar centrals, COCONUT OIL MILLS, cassava mills and desiccated coconut factories.* — Processors of pineapple, proprietors or operators of rope factories, sugar centrals, COCONUT OIL MILLS, cassava mills and desiccated coconut factories shall pay a tax equivalent to *two per centum of the gross value in money of all* the pineapple, rope, sugar, *COCONUT OIL,* cassava flour or starch, and desiccated coconut *manufactured, processed or milled* by them, x x x *such tax to be based on the actual selling price or market value of these articles* at the time they leave the factory or mill warehouse x x x, or as an ingredient or part of any manufactured article or product.

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"x x x x x x x x x

"*Where articles are manufactured out of materials subject to tax under this section, the total cost, as duly established, of the said materials shall be deductible from the gross selling price or gross value in money of the manufactured articles.* (As amended by Sec. 3, Commonwealth Act No. 503; Sec. 6, Republic Act No. 41; Sec. 1, Republic Act No. 261; and Sec. 1, Republic Act No. 822)." (Italics ours).

The Court of Tax Appeals erred in holding that "the *total cost* of the coconut oil which is deductible from the gross selling price of lard, soap and margarine manufactured by the petitioner is the *market value* thereof." "Total cost" and "market value" cannot possibly be the same. As used in the first paragraph of Section 189, "market value" means "*the gross value in money* or the a*ctual selling price* of the coconut oil at the time they leave the factory or mill warehouse." The 2% miller's tax is based *on the market value* of the coconut oil (par. 1, Sec. 189, Tax Code). The 7% sales tax is based on the market value of the manufactured article using coconut oil as a principal ingredient (Sec. 186, Tax Code). Both Sections 186 and 189 of the Tax Code provide that "the total cost" of the material (coconut oil) used in the manufacture of another article is deductible from the gross selling price of the manufactured article. Logically, the "total cost" of such oil would be its *market value plus the 2% miller's tax* that had to be paid before the oil could be used. If the law had intended to deduct only the "market value" of said material, it would have so provided instead of using the term "total cost" which connotes the sum of expenses, costs of production and charges (the 2% miller's tax) that the manufacturer paid for the oil to be able to use it in the manufacture of lard, soap, and margarine.*

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* Then Commissioner of Internal Revenue Jose Arañas in his 3rd Indorsement dated March 25, 1958, in the tax case of the Philippine Manufacturing Company, stated: "Consequently, it must be obvious that if the 2% tax on coconut oil had been actually paid to the Government before the removal of said oil from the oil mill of the taxpayer to its lard and butter factory, *it should form part of the cost of the raw materials deductible from the gross sales of soap, margarine, and lard.*

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The following argument of the petitioner is logical and persuasive:

"To a manufacturer, like petitioner herein, that uses coconut oil manufactured by it in its own oil mill as raw material in the manufacture of lard, soap and margarine, the 'total cost' of the deductible raw materials should likewise include the amount of the 2% miller's tax, since the payment of the tax is required and necessary in order that the manufacturer of such materials can withdraw them and avail of the use thereof as raw material in the manufacture of other articles, such as lard, soap and margarine. This is based on the clear and specific provision of Section 189 of the Revenue Code which requires that the 2% miller's tax imposed on products therein mentioned, including coconut oil, must be paid at the time the products leave or are withdrawn from the factory or mill warehouse. (See *Collector vs. Central Azucarera de Tarlac*, G.R. No. L-11760, July 31, 1958).

"Such being the provision of Section 189, herein petitioner could not have withdrawn the coconut oil from its oil mill and used it as raw material in the manufacture of lard, soap and margarine without paying the 2% miller's tax thereon, otherwise, it would have violated Section 189.

"Since petitioner had to pay, and it did actually pay, the 2% miller's tax when it withdrew the coconut oil from its oil mill, it follows that the 2% miller's tax was already a part of the 'total cost' of the coconut oil when used as raw material in the manufacture of lard, soap and margarine, and, therefore, deductible from the gross selling price of the finished products in computing the 7% sales tax thereon.

"We cannot, therefore, see the logic of respondent Court of Tax Appeals' reasoning that a manufacturer that purchases its raw materials can claim the sales tax that is passed on to it as part of deductible 'total cost,' while a manufacturer that pays the 2% miller's tax on the raw materials manufactured in its oil mill and used by it in

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"Otherwise stated, this Office may grant the deduction of the 2% tax on coconut oil, provided proofs of actual payment of the 2% tax are submitted by the manufacturer of soap, margarine, and lard on the principle above-stated that the 2% tax on coconut oil if actually paid to the Government *would necessarily form part of the deductible cost of said coconut oil which was used as raw material in the making of soap, margarine, and lard.*" (p. 49, BIR Record).

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the manufacture of finished products cannot claim said tax as deductible costs." (pp. 6-7, *Rollo*)

The attempt of the respondent Court to distinguish between a manufacturer and purchaser of coconut oil and to discriminate against the former is unwarranted and unreasonable. To deny to the petitioner the right to deduct the 2% miller's tax enjoyed by other soap, lard, and margarine manufacturers who, unlike the petitioner, *buy*, instead of *produce*, their raw materials would discourage the establishment of integrated or self-sufficient industries. The State would be regressing from, instead of progressing toward, the national goal of self-sufficiency.

It is no argument for disallowing, for purposes of the sales tax, the deduction of the 2% miller's tax as part of the "total cost" of the coconut oil used in the manufacture of lard, soap, and margarine, that the manufacturer (herein petitioner) would enjoy a "double advantage" because it may also deduct the 2% miller's tax from its gross income for purposes of the income tax. Although the petitioner denies that it deducted said miller's tax from its gross income for income tax purposes, the point is, even if it did deduct the 2% tax, the "double advantage" reaped by it would be its just reward for having integrated its industry.

WHEREFORE, the decision of the Court of Tax Appeals and the resolution of the Commission of Internal Revenue assessing deficiency sales tax and surcharges against the petitioner for the period from 1951 to the first quarter of 1956, are reversed and set aside. No costs.

SO ORDERED.

Narvasa, Cruz, Gancayco, and *Medialdea, JJ.,* concur.