FIRST DIVISION

[G.R. No. 222480, November 07, 2018]

AVON PRODUCTS MANUFACTURING, INC., PETITIONER, V. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

D E C I S I O N

TIJAM, J.:

Before Us is a Petition for Review on *Certiorari*[1] under Rule 45 of the Rules of Court filed by petitioner Avon Products Manufacturing, Inc. (Avon) assailing the Decision[2] dated March 16, 2015 and the Resolution[3] dated January 15, 2016 of the Court of Tax Appeals (CTA) En Banc in CTA EB No. 1062 (CTA Case No. 8174), affirming the deficiency assessment of excise tax issued to Avon for the total shortage of 21,163.48 liters of denatured ethyl alcohol, which evaporated during transit from its supplier to Avon's warehouse in Calamba, Laguna.

The antecedent facts

Avon is a manufacturer of perfumes, toilet waters, splash colognes and body sprays. It uses denatured alcohol as a raw ingredient in the manufacture of the above products.[4]

The Bureau of Internal Revenue (BIR) issued a Permit to Buy/Use Denatured Alcohol[5] to Avon dated January 7, 2008. The permit provides that as long as denatured alcohol is used solely in the production of the latter's products, it will be exempted from excise tax. However, the BIR permit imposed a condition[6] that in the event the volume of denatured alcohol purchased by Avon from its suppliers is more than or less than the volume of denatured alcohol actually received by Avon, the latter will be assessed excise tax due on the difference.

From January to December 2008, Avon made various purchases of denatured alcohol from its suppliers amounting to 1,309,000 liters.[7] In accordance with Section 134[8] of the National Internal Revenue Code (NIRC) and the BIR Permit, such purchases were not subjected to excise tax.

However, during transit, marginal quantities of the purchased denatured alcohol evaporated. As such, the BIR issued a Formal Letter of Demand[9] finding Avon liable for deficiency excise tax on distilled spirits[10] on the evaporated denatured alcohol in the amount of Php1,135,500.85.

The BIR alleged that from the 1,309,000 liters of denatured alcohol purchased by Avon from January to December 2008, there were shortages of 21,163.48 liters.

Avon protested the assessment. The BIR issued a Final Decision on Disputed Assessment (FDDA) dated September 1, 2010[11] denying Avon's protest. The latter

filed a Petition for Review before the CTA only assailing the deficiency assessment on the excise tax over the shortages of 21,163.48 liters in the amount of Php738,580.13.[12]

The CTA Second Division in its Decision[13] dated May 16, 2013 ruled in favor of the Commissioner of Internal Revenue (CIR), thus:

> WHEREFORE, premises considered, the instant Petition for Review is hereby DENIED. Accordingly, the deficiency excise tax assessment issued by respondent against petitioner on the total shortage of 21,163.4[8] liters relating to deliveries of denatured ethyl alcohol from January to December 2008 is hereby upheld but in the modified amount of P628,948.21, inclusive of the 25% surcharge imposed under Section 248(A)(3) of the NIRC of 1997, computed as follows:
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> | | |
> |---|---|
> | Basic Tax | P503,187.37 |
> | Surcharge | 125,796.84 |
> | Total | P 628,984.21 |
>
> In addition, petitioner is ORDERED TO PAY:
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> (a) deficiency interest at the rate of twenty percent (20%) per annum on the basic deficiency excise tax of P503,187.37, computed from the delivery dates indicated in respondent's Computation of Deficiency Excise Tax Per Final Decision on Disputed Assessment until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended; and
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> (b) delinquency interest at the rate of twenty percent (20%) per annum on the total amount of P628,984.21, and on the 20% deficiency interest which have accrued as afore-stated in (a), computed from September 7, 2010 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended.
>
> SO ORDERED.[14]

Avon's motion for reconsideration was likewise denied[15] by the CTA Second Division.

Avon elevated the case to the CTA En Banc, the latter however denied[16] Avon's petition and affirmed the decision of the CTA Second Division in a Decision dated March 16, 2015. The motion for reconsideration of Avon suffered the same fate and was denied[17] by the CTA En Banc in a Resolution dated January 15, 2016.

Hence, this petition raising the following assignment of errors:

A.

> THE CTA SERIOUSLY ERRED [THAT] THE PETITIONER FAILED TO PROVE THAT DENATURED ALCOHOL IS SUBJECT OF THE ASSESSMENT AND THAT IT IS EXEMPT FROM EXCISE TAX UNDER SECTION 141 OF THE NIRC.

B.

THE CTA SERIOUSLY ERRED IN RULING THAT RR 3-2006 APPLIES TO THE ASSESSMENT FOR THE EVAPORATED DENATURED ALCOHOL.

C.

THE CTA SERIOUSLY ERRED IN RULING THAT THE *LA TONDEÑA* CASE IS NOT APPLICABLE.

D.

THE CTA SERIOUSLY ERRED WHEN IT IGNORED AND FAILED TO RULE THAT THE CONDITION IN THE BIR PERMIT IS CONTRARY TO THE NIRC.

E.

THE CTA DECISION AND RESOLUTION RUN COUNTER TO THE PRINCIPLE THAT EXCISE TAX UNDER SECTION 141 OF THE NIRC ONLY BE IMPOSED ON A SPECIFIC TAXABLE ARTICLE.

F.

THE CTA SERIOUSLY ERRED IN ITS SIMULTANEOUS IMPOSITION OF [DEFICIENCY] AND DELINQUENCY INTEREST AS THE SAME IS EXCESSIVE AND UNCONSCIONABLE.[18]

Ultimately, the issue for Our resolution is whether Avon should be assessed deficiency excise tax over the shortages of denatured alcohol which evaporated during transit before its processing, rectification or distillation.

Avon's allegations

Avon claimed that Revenue Regulations (RR) No. 3-2006[19] is not applicable to the deficiency assessment for the evaporated denatured alcohol. The CTA erroneously applied the rules meant for distilled spirits to a completely different and tax-exempt article (denatured alcohol). Section 22[20] of RR No. 3-2006 applies to a distiller and to distilled spirits not to denatured alcohol.[21] Avon was not engaged in the business of producing distilled spirits. Hence, the denatured alcohol it purchased and stored should continue to be exempted from excise tax unless it is reprocessed into a distilled spirit. Thus, there was no legal basis to arbitrarily extend its application to denatured alcohol and to Avon, who is not a distiller.[22]

Further, Avon contended that the CTA erred in not applying the case of *La Tondeña Inc., v. Collector of Internal Revenue, et. al.*,[23] where this Court held that "until the spirits requiring rectification has been converted into a finished product, no specific tax shall be due from the rectifier receiving them." Thus, "as long as the alcohol requires rectification, all unintentional, casual, unavoidable and/or natural losses prior to the conversion into some finished product, should not be subject to specific tax."[24] As such, the shortages of 21,163.48 liters of denatured alcohol that evaporated in transit from January to December 2008, which were not subject to rectification nor were converted to a finished product, should not be subject to an excise tax.[25]

Avon also claimed that Condition No. 3[26] contained in Avon's permit to Buy/Use Denatured Alcohol is contrary to the tax exemption as provided under Section 134 of the NIRC. The BIR cannot simply override the provision of the NIRC and arrogate upon itself the authority to impose the excise tax on distilled spirits on a tax-exempt article that evaporated prior to its conversion to a distilled or reprocessed spirit.[27]

Respondent's contentions

The Office of the Solicitor General (OSG), on behalf of the CIR, alleged that while it was not contested that the article subject of the case is denatured alcohol, Avon failed to prove that the same is exempted from excise tax. Avon failed to establish that the denatured alcohol in question was not less than 90% absolute alcohol to qualify exemption under Section 134 of the NIRC. As such, Section 22 of RR No. 3-2006 as to losses on distilled spirits is applicable in the present case.

The Court's ruling

The petition is impressed with merit.

Section 129 of the NIRC provides that *excise taxes apply to goods manufactured or produced in the Philippines for domestic sales or consumption or for any other disposition and to things imported*.

As held in *Commissioner of Internal Revenue v. Pilipinas Shell Petroleum Corporation*,[28] excise tax attaches upon goods manufactured or produced in the Philippines as soon as its existence, thus:

> The transformation undergone by the term "excise tax" from its traditional concept up to its current definition in our Tax Code was explained in the case of *Petron Corporation v. Tiangco*, as follows:
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> > Admittedly, the proffered definition of an excise tax as "a tax upon the performance, carrying on, or exercise of some right, privilege, activity, calling or occupation" derives from the compendium *American Jurisprudence*, popularly referred to as *Am Jur* and has been cited in previous decisions of this Court, including those cited by Petron itself. Such a definition would not have been inconsistent with previous incarnations of our Tax Code, such as the NIRC of 1939, as amended, or the NIRC of 1977 because in those laws the term "excise tax" was not used at all. In contrast, the nomenclature used in those prior laws in referring to taxes imposed on specific articles was "specific tax." Yet beginning with the National Internal Revenue Code of 1986, as amended, the term "excise taxes" was used and defined as applicable "**to goods manufactured or produced in the Philippines... and to things imported.**" (Underscoring ours) This definition was carried over into the present NIRC of 1997. Further, these two latest codes categorize two different kinds of excise taxes: "specific tax" which is imposed and based on weight or volume capacity or any other physical unit of measurement; and "*ad valorem tax*" which is imposed and based on the selling price or other specified value of the goods. In other words, **the meaning of**

> **"excise tax" has undergone a transformation, morphing from the *Am Jur* definition to its current signification which is a tax on certain specified goods or articles.**

The change in perspective brought forth by the use of the term "excise tax" in a different connotation was not lost on the departed author Jose Nolledo as he accorded divergent treatments in his 1973 and 1994 commentaries on our tax laws. Writing in 1973, and essentially alluding to the *Am Jur* definition of "excise tax," Nolledo observed:

> Are specific taxes, taxes on property or excise taxes –
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> In the case of *Meralco v. Trinidad* ([G.R.] 16738, 1925) it was held that specific taxes are property taxes, a ruling which seems to be erroneous. Specific taxes are truly excise taxes for the fact that the value of the property taxed is taken into account will not change the nature of the tax. It is correct to say that specific taxes are taxes on the privilege to import, manufacture and remove from storage certain articles specified by law.

In contrast, after the tax code was amended to classify specific taxes as a subset of excise taxes, Nolledo, in his 1994 commentaries, wrote:

> 1. *Excise taxes*, as used in the Tax Code, **refers to taxes applicable to certain specified goods or articles manufactured or produced in the Philippines for domestic sale or consumption or for any other disposition and to things imported into the Philippines.** *They are either specific or* ad valorem. (Underscoring ours)
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> 2. *Nature of excise taxes*. - They are imposed directly on certain specified goods, (*infra*) They are, therefore, taxes on property, (see *Medina vs. City of Baguio*, 91 Phil. 854.)

A tax is not excise where it does not subject directly the product or goods to tax but indirectly as an incident to, or in connection with, the business to be taxed.

In their 2004 commentaries, De Leon and De Leon restate the *Am Jur* definition of excise tax, and observe that the term is "synonymous with 'privilege tax' and [both terms] are often used interchangeably." At the same time, they offer a caveat that "[ejxcise tax, as [defined by *Am Jur*], is not to be confused with excise tax imposed [by the NIRC] on certain specified articles manufactured or produced in, or imported into, the Philippines, 'for domestic sale or consumption or for any other disposition.'"

It is evident that *Am Jur* aside, the current definition of an excise tax is that of a tax levied on a specific article, rather than one "upon the performance, carrying on, or the exercise of an activity." This current definition was already in place when the Code was enacted in 1991, and we can only presume that it was what the Congress had intended as it specified that local government units could not impose