November 25, 2019

BIR RULING NO. 700-19

Section 141 of the National Internal
Revenue Code of 1997, as amended;
Revenue Regulations No. 17-2012

Emperador Distillers, Inc.
7F 1880 Eastwood Avenue, Eastwood CyberPark
E. Rodriguez Jr. Avenue (C5)
Bagumbayan, Quezon City

Attention: *AAA*

Gentlemen :

This refers to your request for a ruling allowing Emperador Distillers, Inc. to denature its damaged or sub-standard inventories of ethyl alcohol to render it unfit for oral intake, and remove or sell the same without pre-payment of excise tax to buyers/manufacturer engaged in non-liquor business such as producers of rubbing alcohol or producers of personal care products.

Background:

As represented, Emperador Distillers, Inc. is a manufacturer of compounded liquor products, with ethyl alcohol as chief ingredient, intended for the domestic and export market.

As a prime producer of established liquor brands for the local and international market, its raw ethyl alcohol is subjected to a strict rectification process to ensure that the alcohol meets a certain organoleptic standard prior to the blending and compounding stage. In line with its enhanced quality control protocols, certain batches of its rectified alcohol were found to be unfit, yielding characteristics unsuitable for compounding and bottling purposes. For this reason, Emperador Distillers, Inc. segregated 850,000 liters of these batches of sub-standard alcohol from its existing domestic inventory so as not to compromise the integrity of its bottled premium liquor brands.

These damaged batches would remain a permanently idle and unusable inventory if not disposed of. It would occupy a very significant storage space which could be otherwise be used to store new and quality stock. Emperador Distillers, Inc. is therefore compelled to apply for the needed permit from the Bureau of Internal Revenue (BIR) to

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take this damaged inventory out of its premises without pre-payment of the excise tax imposed under Section 141 of the National Internal Revenue Code of 1997, as amended, and sell the same as denatured alcohol unfit for oral intake to a duly authorized buyer/manufacturer engaged in non-liquor business such as producers of rubbing alcohol or personal care products.

However, in its interaction with the concerned personnel of the Excise Tax Division of the BIR, Emperador Distillers, Inc. was informed that its request to denature and remove its damaged alcohol and sell the same to non-liquor buyer may not be given due course because of the following existing administrative issuances:

a) Revenue Memorandum Circular (RMC) No. 3-2013 which states that "x x x all end-products (of distilled spirits) such as ethyl alcohol, ethanol or other similar products or mixtures are separate and distinct distilled spirits apart from whisky, brandy, rum, etc. and therefore the same should be likewise subjected to the imposition of a separate and distinct excise tax.

b) The same RMC likewise mentions that in the case of registered compounder of ethyl alcohol, any removal of compounded liquor shall be subject to excise tax for being deemed compounded alcohol of Emperador Distillers, Inc. and cannot be denatured or removed without payment of excise tax.

On the other hand, Emperador Distillers, Inc. alleged that the above administrative interpretations are no longer rational or applicable as a result of the overhaul of the then existing excise taxation system as effected by Republic Act (RA) No. 10351 which was approved on December 9, 2012. This law changed the excise taxation of distilled spirits from purely specific tax to compound tax structure to comply with the World Trade Organization (WTO) ruling on the discriminatory taxation on imported distilled spirits in the country. Accordingly, Section 141 of the National Internal Revenue Code of 1997, as amended, was further amended by RA No. 10351 to among others, remove the provision on the complaints of the European Union and the United States of America by abandoning the use of raw materials as basis for taxation and by imposing a compound tax of *ad valorem* based on Net Retail Price (NRP) per proof and specific tax per proof liter.

Hence, any distinction between local and imported alcohol has been removed, such that all distilled spirits whether imported or locally produced are now subject to the same excise tax rates based on removal of finished products and not on ingredients as a result of amendment to Section 141 of the National Internal Revenue Code of 1997, as amended. Thus, Emperador Distillers, Inc. now request to denature and remove damaged alcohol inventory and that the same is not subject to excise tax, citing the following justifications:

1. The first inconsistency is the administrative interpretation that ethyl alcohol is still taxable in whatever form, irrespective of the use to which it is intended. For Emperador Distillers, Inc., its raw alcohol inventory is an ingredient, not its end product. Hence, while alcohol

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may be taxable as a separate and distinct product of a local distillery in certain cases, it is not so in the hands of a manufacturer of compounded liquors. Pursuant to RA No. 10351, Emperador Distillers, Inc. as an importer and compounder, is no longer taxed on its local purchase or importation of alcohol as an ingredient to produce bottled products. As clearly enunciated by RMC No. 18-2013, thus:

> "x x x (t)he importation of ethyl alcohol or ethanol intended for re-sale or for the manufacture of compounded liquors shall be subject to excise tax unless the importer thereof is a holder of a Permit to Operate as importer of ethyl alcohol or ethanol or as a manufacturer of compounded liquors, as the case may be, duly issued by this Bureau and has posted a surety bond, in addition to the importer's bond prescribed under Section 160 of the National Internal Revenue Code (NIRC) of 1997, as amended. x x x"
>
> "In case of domestic sale of ethyl alcohol or ethanol by duly registered manufacturers thereof, otherwise known as distilleries, the sale and delivery of ethyl alcohol or ethanol directly to manufacturers compounded liquors, shall be subject to excise tax, unless a surety bond shall be posted by distillery, in addition to the manufacturer's bond prescribed under Section 160 of the NIRC of 1997."

Rather, Emperador Distillers, Inc. is now taxed on every removal of finished products statutorily pegged on "Suggested Net Retail Price" which is defined as the "net retail price at which locally manufactured or imported distilled spirits are intended by the manufacturer or importer to be sold on retail in major supermarkets or retail outlets x x x."

Consequently, the *ad valorem* tax and specific tax on alcohol only attach on the finished liquor products removed from the place of production. Since the tax is applied on the retail price of finished bottled products, how can this specific taxing method be legally or correctly made to apply over the removal of a mere ingredient when the same is not sold on retail.

2. The second inconsistency is the administrative interpretation to maintain a distinction between imported alcohol and domestic alcohol for tax treatment purposes. It is the BIR's apparent position that Emperador Distillers, Inc.'s imported inventory of alcohol cannot be denatured because denaturing applies only to locally produced alcohol. Since the intention of the law is to maintain a *pari passu* regime or to treat these two sources on equal footing, then there is no more legal basis to impose excise tax on imported alcohol intended for denaturing while exempting domestic alcohol destined for the same purpose. In

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fact, the National Internal Revenue Code of 1997, as amended, prescribes the general rule that "*x x x imported articles shall be subject to the same rates and basis of excise taxes applicable to locally manufactured articles*."

Even Revenue Regulations (RR) No. 3-2006, which laid down the denaturing rules only for domestic alcohol, were anchored on RA No. 9334 which is a law that still contains the preferential treatment for domestic alcohol producers. Again, that policy was already removed by RA No. 10351. The BIR will appreciate the fact that the previous policy granting preferential treatment to locally produced alcohol originated from legislations dating back to the Commonwealth era when the fledging local producers require protection to attain growth. The modern economic milieu is now vastly different where local production cannot adequately cope up with current demand, hence the shift in policy direction is all the more appropriate.

Also, what Emperador Distillers, Inc. will be removing is not compounded liquor but ethyl alcohol that would be subjected to denaturing process to render it unfit for oral intake, thus, not subject to excise tax.

In reply, please be informed that as stated in the Reports of the Appellate Body of the WTO on "Philippines — Taxes on Distilled Spirits" dated December 21, 2011, the European Union and the United States claimed that the Philippines has acted inconsistently with Article III:2, first and second sentences, of the General Agreement on Tariffs and Trade (GATT) 1994, in applying different tax treatment to distilled spirits produced from the sap of the nipa, coconut, cassava, camote or buri palm, or from juice, syrup, or sugar of the cane ("designated raw materials") and to distilled spirits made from other raw materials ("non-designated raw materials"). For the reasons set out in its Reports, the Panel found, in relation to the complaint by the European Union, that the Philippines has acted inconsistently with its obligations under Article III:2, first sentence, of the GATT 1994. More specifically, the Panel found that:

> . . . through its excise tax the Philippines subjects imported distilled spirits made from raw materials other than those designated in its legislation to internal taxes in excess of those applied to like domestic spirits made from the designated raw materials, and is thus acting in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

The Panel also found, in relation to the complaint by the United States, that the Philippines has acted inconsistently with its obligations under Article III:2, first and second sentences, of the GATT 1994. More specifically, the Panel found that:

(a) through its excise tax, the Philippines subjects imported distilled spirits made from raw materials other than those designated in its

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legislation to internal taxes in excess of those applied to like domestic spirits made from the designated raw materials, and is thus acting in a manner inconsistent with Article III:2, first sentence, of the GATT 1994; and

(b) through its excise tax, the Philippines applies dissimilar internal taxes on domestic distilled spirits made from designated raw materials and to directly competitive or substitutable imported distilled spirits made from other raw materials in a manner so as to afford protection to the Philippine domestic production of distilled spirits and is thus acting in a manner inconsistent with Article III:2, second sentence, of the GATT 1994.

The above substantial distinction and preferential tax treatment on local alcohol versus imported alcohol was thereafter removed by RA No. 10351, popularly known as the Sin Tax Law, amending among others Section 141 of the National Internal Revenue Code of 1997, as amended, which provides as follows:

"***SEC. 141. Distilled Spirits.*** *— On distilled spirits, subject to the provisions of Section 133 of this Code, an excise tax shall be levied, assessed and collected based on the following schedules:*

xxx xxx xxx

(b) Effective on January 1, 2015

(1) An ad valorem tax equivalent to twenty percent (20%) of the net retail price (excluding the excise tax and the value-added tax) per proof; and

(2) In addition to the ad valorem tax herein imposed, a specific tax of Twenty pesos (P20.00.) per proof liter.

(c) In addition to the ad valorem tax herein imposed, the specific tax rate of Twenty pesos (P20.00) imposed under this Section shall be increased by four percent (4%) every year thereafter effective on January 1, 2016, through revenue regulations issued by the Secretary of Finance.

xxx xxx xxx

This tax shall be proportionally increased for any strength of the spirits taxed over proof spirits, and the tax shall attach to this substance as soon as it is in existence as such, whether it be subsequently separated as pure or impure spirits, or transformed into any other substance either in the process of original production or by any subsequent process.

'Spirits or distilled spirits' *is the substance known as* ***ethyl alcohol, ethanol*** *or spirits of wine, including all dilutions, purifications and mixtures thereof, from whatever source, by whatever process produced, and shall include whisky, brandy,*

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rum, gin and vodka, and other similar products or mixtures. (Emphasis and underscoring supplied)

xxx xxx xxx"

To implement the said law, Revenue Regulations (RR) No. 17-2012 [1] dated December 21, 2012 was issued, which was further clarified by RMC No. 3-2013, as amended by RMC No. 18-2013, to *wit*:

> *"For this purpose, the* ***importation of ethyl alcohol or ethanol*** *intended for re-sale or for the manufacture of compounded liquors shall be subject to excise tax unless the importer thereof is a holder of a Permit to Operate as importer of ethyl alcohol or ethanol or as a manufacturer of compounded liquors, as the case may be, duly issued by this Bureau and has posted a surety bond, in addition to the importer's bond prescribed under Section 160 of the National Internal Revenue Code (NIRC) of 1997, as amended. The amount of the surety bond shall be equivalent to the average total value of ethyl alcohol or ethanol imported for a two-month (2) period computed by the estimated total value of ethyl alcohol or ethanol imported during the year divided by six (6) months. The value referred herein shall be that value used by the Bureau of Customs in determining tariff and customs duties.*
>
> ***In case of domestic sale of ethyl alcohol or ethanol*** *by duly registered manufacturers thereof, otherwise known as distilleries, the sale and delivery of ethyl alcohol or ethanol directly to manufacturers of compounded liquors shall be subject to excise tax, unless a surety bond shall be posted by the distillery, in addition to the manufacturer's bond prescribed under Section 160 the NIRC of 1997. The amount of surety bond shall be equivalent to the total value, per sales invoice, of ethyl alcohol or ethanol sold to the manufacturers of compounded liquors for a two-month (2) period computed by the estimated total value of ethyl alcohol or ethanol sold during the year divided by six (6) months. Moreover, the sale and delivery of ethyl alcohol or ethanol without the payment of the excise tax to be used as raw material in the manufacture of compounded liquors shall not be allowed unless the buyer thereof is a holder of a Permit to Operate as manufacturer of compounded liquors duly issued by this Bureau.*
>
> ***The removal of ethyl alcohol from the distilleries for purposes other than the manufacture of compounded liquors such as for use as blending component for gasoline under RA No. 9367, otherwise known as the "Biofuel Act of 2006," or for industrial and pharmaceutical purposes, shall be denatured according to existing rules and regulations on denaturation in order that the same shall not be subject to excise tax****. However, the removal of ethyl alcohol or ethanol from distilleries for purposes of rectification shall be conditionally tax-exempt and the excise tax due on the rectified alcohol shall be paid by the rectifier pursuant to the provisions of Section 137 of the NIRC of 1997, as amended, and implementing rules and regulations thereof. In case the rectifier shall remove and deliver the rectified alcohol to manufacturers of compounded liquors, such removal shall not be subject to excise tax provided that a surety bond in an amount similar to that provided above for distilleries shall have been posted by the rectifier.*

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Provided, however, that in case the amount of the surety bond herein prescribed shall be less than the amount of excise tax due on the total actual importations or sales, as the case may be, of ethyl alcohol for the two-month period, the difference which is not covered by the surety bond shall be immediately paid by the above-mentioned persons concerned to the Bureau of Internal Revenue (BIR) without prior notice of demand.

The duly registered importer of ethyl alcohol or ethanol intended for resale shall be liable to the excise tax on sale and delivery thereof to persons or entity other than to manufacturers of compounded liquors. The said importer shall submit a notarized liquidation statement containing the dates of receipt, Bill of Lading number and volume of imported ethyl alcohol or ethanol, the dates, names of all its customers, whether or not manufacturers of compounded liquors and corresponding total volume of the said product sold and delivered during the two-month period of operation to the appropriate office of the BIR within ten (10) days immediately following the end of every two-month period. The excise tax due on sale and delivery to non-manufacturers of compounded liquors shall be paid simultaneously with the payment, if any, of the excise tax not covered by the surety bond mentioned in the preceding paragraph.

Considering that all existing manufacturers of compounded liquors are now liable to pay the excise tax on every removal of compounded liquors from its place of production pursuant to RA No. 10351, the amount of the initial manufacturer's bond prescribed under Section 160 of the NIRC of 1997, as amended, shall be equivalent to the excise due on the total volume of compounded liquors that have been actually removed from the place of production in the immediately previous year of operation." (Emphasis and underscoring supplied)

Applying the aforequoted provisions, and to give meaning and life to the mandate of the law for locally manufactured and imported articles to have the same rates and basis of excise tax in line with the WTO ruling, we allow Emperador Distillers, Inc. — taken into account the peculiar circumstances it presented — to suitably denature its damaged or sub-standard inventory of ethyl alcohol, which, as represented, is about 850,000 liters, in order to render it unfit for oral intake, and to remove the same without pre-payment of excise tax for sale to buyers/manufacturers engaged in non-liquor business such as producers of rubbing alcohol or producers of personal care products, subject to strict compliance with the current and existing rules and regulations on denaturation and sale of the denatured alcohol, including but not limited to:

(1) BIR's approval of the formula to be used in the denaturation;

(2) Permit issued to the buyer of denatured alcohol;

(3) Denaturation shall be conducted in the presence of the duly authorized representative of the BIR;

(4) Duly notarized liquidation statement on the disposition of denatured alcohol, supported by certified true copies of the sales invoices, delivery receipts, and

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Official Delivery Invoices, as the case may be; and

(5) Statement on the quantity of ethyl alcohol to be denatured (in gauge liters and proof liters).

It is understood that in the event the denatured alcohol has been rendered fit again for oral intake, the qualified buyer or the person who conducted the rectification or re-distillation of the same shall be liable to pay, upon demand, the excise tax due thereon, inclusive of penalties. It is further understood that denaturation of ethyl alcohol outside of what has been allowed herein shall be separately evaluated and approved by the BIR following strictly the current and existing rules and regulations on denaturation and sale of denatured alcohol.

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be disclosed that the facts are different, then this ruling shall be considered null and void.

Very truly yours,

(SGD.) CAESAR R. DULAY
Commissioner of Internal Revenue

Footnotes

1. Prescribing the Implementing Guidelines on the Revised Tax Rates on Alcohol and Tobacco Products Pursuant to the Provisions of Republic Act No. 10351 and to Clarify Certain Provisions of Existing Revenue Regulations.

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