

LIDDELL & CO., INC., PETITIONER AND APPELLAT, VS. THE COLLECTOR OF INTERNAL REVENUE, RESPONDENT AND APPELLEE.

G.R. No. L-9687. June 30, 1961

Ponente: BENGZON, C.J.

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BENGZON, C.J.:

This is an appeal from the decision of the Court of Tax Appeals imposing a tax deficiency liability of P1,317,629.61 on Liddell & Co., Inc.

Said company lists down several issues which may be boiled to the following:

- (a) Whether or not Judge Umali of the Tax Court below could validly participate in the making of the decision;
- (b) Whether or not Liddell & Co. Inc., and the Liddell Motors Inc. are (practically) identical corporations, the latter being merely the alter ego of the former;
- (c) Whether or not, granting the identical nature of the corporations, the assessment of tax liability, including the surcharge thereon, by the Court of Tax Appeals, is correct.

Undisputed Facts.—The parties submitted a partial stipulation of facts, each reserving the right to present additional evidence.

Said undisputed facts are substantially as follows:

The petitioner, Liddell & Co. Inc., (Liddell & Co. for short) is a domestic corporation established in the Philippines on February 1, 1946, with an authorized capital of P100,000 divided into 1000 shares at P100 each. Of this authorized capital, 196 shares valued at P19,600 were subscribed and paid by Frank Liddell while the other four shares were in the name of Charles Kurz, E. J. Darras, Angel Manzano and Julian Serrano at one share each. Its purpose was to engage in the business of importing and retailing Oldsmobile and Chevrolet passenger cars and GMC and Chevrolet trucks.

On January 31, 1947, with the limited paid-in capital of P20,000, Liddell & Co. was able to declare a 900% stock dividend after which declaration, Frank Liddell's holdings in the company increased to 1,960 shares and the employees, Charles Kurz, E.J. Darras, Angel Manzano and Julian Serrano at 10 shares each. The declaration of stock dividend was followed by a resolution increasing the authorized capital of the company to P1,000,000 which the Securities & Exchange Commission approved on March 3, 1947. Upon such approval, Frank Liddell subscribed to 3,000 additional shares, for which he paid into the corporation P300,000 so that he had in his own name 4,960 shares.

On May 24, 1947, Frank Liddell, on one hand and Messrs.Kurz, Darras, Manzano and Serrano on the other, executed an agreement (Exhibit A) which was further supplemented by two other agreements (Exhibits B and C) dated May 24, 1947 and June 3, 1948, wherein Frank Liddell transferred (On June 7, 1948) to various employees of Liddell & Co. shares of stock.

At the annual meeting of stockholders of Liddell & Co. held on March 9, 1948, a 100% stock dividend was declared, thereby increasing the issued capital stock of said corporation to P1,000,000. The stockholders also approved a resolution increasing the authorized capital stock from P1,000,000 to P3,000,000 which increase was duly approved by the Securities and Exchange Commission on June 7, 1948. Frank Liddell subscribed to and paid 20% of the increase of P400,000. He paid 25% thereof in the amount of P100,000 and the balance of P300,000 was merely debited to Frank Liddell-Drawing Account and credited to Subscribed Capital Stock on December 31, 1948.

On March 8, 1949, stock dividends were again issued by Liddell & Co. and in accordance with the agreements, Exhibits A, B, and C, the stocks of said company stood as follows:

Name No. of Amount Percent

Shares

Frank Liddell 13,638 P1,368,800 72.00%

Irene Liddell 1 100 .01%

Mercedes Vecin 1 100 .01%

Charles Kurz 1,225 122,500 6.45%

E. J. Darras 1,225 122,500 6.45%

Angel Manzano 1,150 115,000 6.06%

Julian Serrano 710 71,000 3.74%

E. Hasim 500 50,000 2.64%

G. W. Kernot 500 50,000 2.64%

19,000 P1,900,000 100.00%

On November 15, 1948, in accordance with a resolution of a special meeting of the Board of Directors of Liddell & Co. stock dividends were again declared. As a result of said declaration and in accordance with the agreements, Exhibits, A, B, and C, the stockholdings in the company appeared to be:

Name No. of Amount Percent

Shares

Frank Liddell 19,738 P1,973,800 65.791%

Irene Liddell 1 100 .003%

Mercedes Vecin 1 100 .003%

Charles Kurz 2,215 221,500 7.381%

E.J. Darras 2,215 221,500 7.381%

Angel Manzano 1,810 181,000 6.031%

Julian Serrano 1,700 170,000 5.670%

E. Hasim 830 83,000 2.770%

G.W. Kernot 1,490 149,000 4.970%

30,000 P3,000,000 100.00%

On the basis of the agreement Exhibit A, (May, 1947) 55% of the earnings available for dividends accrued to Frank Liddell although at the time of the execution of said instrument, Frank Liddell owned all of the shares in said corporation. 45% accrued to the employees, parties thereto: Kurz 12½%; Darras 12½%; A. Manzano 12½% and Julian Serrano 7½%. The agreement Exhibit A was also made retroactive to 1946. Frank Liddell reserved the right to reapportion the 45% dividends pertaining to the employees in the future for the purpose of including such other faithful and efficient employees as he may subsequently designate. (As a matter of fact, Frank Liddell did so designate, two additional employees namely: E. Hasim and G. W. Kernot). It was for such inclusion of future faithful employees that Exhibits B-1 and C were executed. As per Exhibit C, dated May 13, 1948, the 45% given by Frank Liddell to his employees was reapportioned as follows: C. Kurz—12%; E. J. Darras—12%; A. Manzano—12%; J. Serrano 3½%; G. W. Kernot—2%.

Exhibit B contains the employees' definition in detail of the manner by which they sought to prevent their shareholdings from being transferred to others who may be complete strangers to the business of Liddell & Co.

From 1946 until November 22, 1948 when the purpose clause of the Articles of Incorporation of Liddell & Co. Inc., was amended so as to limit its business activities to importations of automobiles and trucks, Liddle & Co. was engaged in business as an importer and at the same time retailer of Oldsmobile and Chevrolet passenger cars and GMC and Chevrolet trucks.

On December 20, 1948, the Liddle Motors, Inc. was organized and registered with the Securities and Exchange Commission with an authorized capital stock of P100,000 of which P20,000 was subscribed and paid for as follows: Irene Liddle, wife of Frank Liddell, 19,996 shares and Messrs, Marcial P. Lichauco, E. K. Branwell, V. E. del Rosario and Esmenia Silva, 1 share each.

At about the end of the year 1948, Messrs. Manzano, Kurz and Kernot resigned from their respective positions in the Retail Dept. of Liddell & Co. and they were taken in and employed by Liddell Motors, Inc., Kurz as Manager-Treasurer, Manzano as General Sales Manager for cars and Kernot as General Sales Manager for trucks.

Beginning January, 1949, Liddell & Co. stopped retailing cars and trucks; it conveyed them instead to Liddell Motors, Inc. which in turn sold the vehicles to the public with a steep mark-up. Since then, Liddell & Co. paid sales taxes on the basis of its sales to Liddell Motors, Inc. considering said sales as its original sales.

Upon review of the transactions between Liddell & Co. and Liddell Motors Inc., the Collector of Internal Revenue determined that the latter was but an alter ego of Liddell & Co. Wherefore, he concluded, that for sales tax purposes, those sales made by Liddell Motors, Inc. to the public were considered as the original sales of Liddell & Co. Accordingly, the Collector of Internal Revenue assessed against Liddell & Co. a sales tax deficiency, including surcharges, in the amount of P1,317,629.61. In the computation, the gross selling price of Liddell Motors, Inc. to the general public from January 1, 1949 to September 15, 1950. was made the basis without deducting from the selling price, the taxes already paid by Liddell & Co. in its sales to the Liddell Motors, Inc.

The Court of Tax Appeals upheld the position taken by the Collector of Internal Revenue.

- Judge Umali—Appellant urges the disqualification of Judge Roman M. Umali to participate in the decision of the instant case because he was Chief of the Law Division, then Acting Deputy Collector and later Chief Counsel of

the Bureau of Internal Revenue during the time when the assessment in question was made.[1] In refusing to disqualify himself despite admission that he had held the, aforementioned offices, Judge Umali stated that he had not in any way participated, nor expressed any definite opinion, on any question raised by the parties when this case was presented for resolution before the said bureau. Furthermore, after careful inspection of the records of the Bureau, he (Judge Umali as well as the other members of the Court below), had not found any indication that he had expressed any opinion or made any decision that would tend to disqualify him from participating in the consideration of the case in the Tax Court.

At this juncture, it is well to consider that petitioner did not question the truth of Judge Umali's statements. In view thereof, this Tribunal is not inclined to disqualify said judge. Moreover, in furtherance of the presumption of a judge's moral sense of responsibility this Court has adopted, and now here repeats, the ruling that the mere participation of a judge in prior proceedings relating to the subject in the capacity of an administrative official does not necessarily disqualify him from acting as judge.[2]

Appellant also contends that Judge Umali signed the said decision contrary to the provision of Section 13, Republic Act No. 1125,[3] that whereas the case was submitted for decision of the Court of Tax Appeals on July 12, 1955, and the decision of Associate Judge Luciano and Judge Nable were both signed on August 11, 1955 (that is, on the last day of the 30-day period provided for in Section 13, Republic Act No. 1125). Judge Umali signed the decision August 31, 1955 or 20 days after the lapse of the 30-day period allotted by law.

By analogy it may be said that inasmuch as in Republic Act No. 1125 (law creating the Court of Tax Appeals) like the law governing the procedure in the Court of Industrial Relations, there is no provision invalidating decisions rendered after the lapse of 30 days, the requirement of Section 13, Republic Act No. 1125 should be construed as directory.[4]

Besides as pointed out by appellee, the third paragraph of Section 13 of Republic Act No. 1125 (quoted in the margin)[5] confirms this view, because in providing for two thirty-day periods, the law means that decisions may still be rendered within the second period of thirty days (Judge Umali signed his decision within that period).

- Identity of the two corporations.—On the question whether or not Liddell Motors, Inc. is the alter ego of Liddell & Co. Inc., we are fully convinced that Liddell & Co. is wholly owned by Frank Liddell. As one of the time of its organization, 98% of the capital stock belonged to Frank Liddell. The 20% paid-up subscription with which the company began its business was paid by him. The subsequent subscriptions to the capital stock were made by him and paid with his own money.

These stipulations and conditions appear in Exhibit A: (1) that Frank Liddell had the authority to designate in the future the employee who could receive earnings of the corporation; to apportion among the stockholders the share in the profits; (2) that all certificates of stock in the names of the employees should be deposited with Frank Liddell duly endorsed in blank by the employees concerned; (3) that each employee was required to sign an agreement with the corporation to the effect that, upon his death or upon his retirement or separation for any cause whatsoever from the corporation, the said corporation should, within a period of sixty days therefor, have the absolute and exclusive option to purchase and acquire the whole of the stock interest of the employees so dying, resigning, retiring or separating.

These stipulations in our opinion attest to the fact that Frank Liddell owned Liddell & Co. Inc. They guarantee his complete control over the corporation.

As to Liddell Motors Inc. we are fully persuaded that Frank Liddell also owned it. He supplied the original capital funds.[6] It is not proven that his wife Irene, ostensibly the sole incorporator of Liddell Motors Inc. had money of

her own to pay for her P20,000 initial subscription.[7] Her income in the United States in the year 1943 and 1944 and the savings therefrom could not be enough to cover the amount of subscription, much less to operate an expensive trade like the retail of motor vehicles. The alleged sale of her property in Oregon might have been true, but the money received therefrom was never shown to have been saved or deposited so as to be still available at the time of the organization of the Liddell Motors, Inc.

The evidence at hand also shows that Irene Liddell had scant participation in the affairs of Liddell Motors, Inc. She could hardly be said to possess business experience. The income tax forms record no independent income of her own. As a matter of fact, the checks that represented her salary and bonus from Liddell Motors, Inc. found their way into the personal account of Frank Liddell. Her frequent absences from the country negate any active participation in the affairs of the Motors company.

There are quite a series of conspicuous circumstances that militate against the separate and distinct personality of Liddell Motors, Inc. from Liddell & Co.[8] We notice that the bulk of the business of Liddell & Co. was channelled through Liddell Motors, Inc. On the other hand, Liddell Motors, Inc. pursued no activities except to secure cars, trucks, and spare parts from Liddell & Co. Inc. and then sell them to the general public. These sales of vehicles by Liddell & Co. to Liddell Motors, Inc. for the most part were shown to have taken place on the same day that Liddell Motors, Inc. sold such vehicles to the public. We may even say that the cars and trucks merely touched the hands of Liddell Motors, Inc. as a matter of formality.

During the first six months of 1949, Liddell & Co. issued ten (10) checks payable to Frank Liddell which were deposited by Frank Liddell in his personal account with the Philippine National Bank. During this time also, he issued in favor of Liddell Motors, Inc. six (6) checks drawn against his personal account with the same bank. The checks issued by Frank Liddell to the Liddell Motors, Inc. were significantly for the most part issued on the same day when Liddell & Co., Inc. issued the checks for Frank Liddell[9] and for the same amounts.

It is of course accepted that the mere fact that one or more corporations are owned and controlled by a single stockholder is not of itself sufficient ground for disregarding separate corporate entities. Authorities[10] support the rule that it is lawful to obtain a corporation charter, even with a single substantial stockholder, to engage in a specific activity, and such activity may co-exist with other private activities of the stockholder. If the corporation is a substantial one, conducted lawfully and without fraud on another, its separate identity is to be respected.

Accordingly, the mere fact that Liddell & Co. and Liddell Motors, Inc. are corporations owned and controlled by Frank Liddell directly or indirectly is not by itself sufficient to justify the disregard of the separate corporate identity of one from the other. There is however, in this instant case, a peculiar consequence of the organization and activities of Liddell Motors, Inc.

Under the law in force at the time of its incorporation the sales tax on original sales of cars (sections 184, 185 and 186 of the National Internal Revenue Code), was progressive, i.e. 10% of the selling price of the car if it did not exceed P5,000, and 15% of the price if more than P5,000 but not more than P7,000, etc. This progressive rate of the sales tax naturally would tempt the taxpayer to employ a way of reducing the price of the first sale. And Liddell Motors, Inc. was the medium created by Liddell & Co. to reduce the price and the tax liability.

Let us illustrate: a car with engine motor No. 212381 was sold by Liddell & Co., Inc. to Liddell Motors, Inc. on January 17, 1949 for P4,546,000.55 including tax; the price of the car was P4,133,000.23, the tax paid being P413.22, at 10%. And when this car was later sold (on the same day!) by Liddell Motors, Inc. to P.V. Luistro for P5,500, no more sales tax was paid.[11] In this price of P5,500 was included the P413.32 representing taxes paid by Liddell & Co. Inc. in the sale to Liddell Motors, Inc. Deducting P413.32 representing taxes paid by Liddell & Co., Inc. from the price of P5,500, the balance of P5,087.68 would have been the net selling price of Liddell &

Co., Inc. to the general public (had Liddell Motors, Inc. not participated and intervened in the sale), and 15% sales tax would have been due. In this transaction, P349.68 in the form of taxes was evaded. All the other transactions (numerous) examined in this light will inevitably reveal that the Government coffers had been deprived of a sizable amount of taxes.

As opined in the case of *Gregory vs. Kolvering*,^[12] "the legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." But, as held in another case,^[13] "where a corporation is a dummy, is unreal or a sham and serves no business purpose and is intended only as a blind, the corporate form may be ignored for the law cannot countenance a form that is bald and mischievous fiction."

Consistently with this view, the United States Supreme Court^[14] held that "a taxpayer may gain advantage of doing business thru a corporation if he pleases, but the revenue officers in proper cases, may disregard the separate corporate entity where it serves but as a shield for tax evasion and treat the person who actually may take the benefits of the transactions as the person accordingly taxable."

Thus we repeat: to allow a taxpayer to deny tax liability on the ground that the sales were made through another and distinct corporation when it is proved that the latter is virtually owned by the former or that they are practically one and the same is to sanction a circumvention of our tax laws.^[15]

- Tax liability computation:—In the *Yutivo* case:^[16] the same question involving the computation of the alleged deficiency sales tax has been raised. In accordance with our ruling in said case we hold as correctly stated by Judge Nable in his concurring and dissenting opinion on this case, that the deficiency sales tax should be based on the selling price obtained by Liddell Motors, Inc. to the public after deducting the tax already paid by the Liddell & Co. Inc. in its sales to Liddell Motors, Inc.

On the imposition of the 50% surcharge by reason of fraud, we see that the transactions between Liddell Motors, Inc. and Liddell & Co. have always been embodied in proper documents, constantly subject to inspection by the tax authorities. Liddell & Co. have always made a full report of its income and receipts in its income tax returns.

Paraphrasing our decision in the *Yutivo* case, we may now say, in filing its return on the basis of its sales to Liddell Motors, Inc. and not on those by the latter to the public, it cannot be held that the Liddell & Co. deliberately made a false return for the purpose of defrauding the government of its revenues, and should suffer a 50% surcharge. But penalty for late payment (25%) should be imposed.

In view of the foregoing, the decision appealed from is hereby modified: Liddell & Co. Inc. is declared liable only for the amount of P426,811.67 with 25% surcharge for late payment and 6% interest thereon from the time the judgment becomes final.

As it appears, that, during the pendency of this litigation, appellant paid under protest to the Government the total amount assessed by the Collector, the latter is hereby required to return the excess to the petitioner.

No costs.

Padilla, Labrador, Concepcion, Reyes, J.B.L., Barrera, Paredes, Dizon, de Leon, and Natividad, JJ., concur.

[1] Section 5, Rep. Act No. 1125; "Judges of the said Court shall be disqualified from sitting in any case on the same grounds provided under Rule one hundred twenty-six of the Rules of Court for the disqualification of judicial officers."

[2] Govt. of the Phil. vs. Heirs of Abella, 49 Phil., 374.

[3] Sec. 13, Republic Act No. 1125; Decision. Cases brought before the Court shall be decided within thirty days after the submission thereof for decision.

[4] See case of Permanent Concrete Products, Inc., and Santiago vs. Juan Frivalden, L-14179, September 15, 1960.

[5] "If no decision is rendered by the Court within thirty days from the date a case is submitted for decision, the party adversely affected by said ruling, order or decision, may file with said Court a notice of intention to appeal, and if, within thirty days from the filing of said notice, no decision has as yet been rendered by the Court, the aggrieved party may file directly with the Supreme Court an appeal from said decision, ruling or order, notwithstanding the foregoing provisions of this section." (*Italics ours*).

[6] In fact it was paid by her husband's personal check.

[7] The other four owned only one share each.

[8] Appellee's Brief describes several. We mention a few only.

[9] See Exhibits 2 to 17.

[10] Burnet Commissioner vs. Clarke, 287 U.S. 410, 53 S. Ct. 207 99, 77 L. ed, 397; Burnet Commissioner vs. Commonwealth Improvement Co., 287 U.S. 415, 53 S. Ct. 198, 77 L. ed.

[11] At this price sales tax of 15% would have represented P825.

[12] 293 U.S. 465, 79 L. ed. 596, 599, 55 S. Ct.

[13] Higgings vs. Smith 1940, 308 U.S. 406, 84 L. ed.

[14] Higgings vs. Smith (*supra*).

[15] Cf. Koppel vs. Yatco, 77 Phil. 496.

[16] Yutivo & Son Hardware Co. vs. The Collector of Internal Revenue, 110 Phil., 750.

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