

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. NORTON HARRISON COMPANY, RESPONDENT.

G. R. No. 17618. August 31, 1964

Ponente: PAREDES, J.

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PAREDES, J.:

This is an appeal interposed by the Commissioner of Internal Revenue against the loiiuwng judgment of the Court of Tax Appeals:

"In view of the foregoing, we find no legal basis to support the assessment in question against petitioner. If at all, the assessment should have been directed against JACKBILT, the manufacturer. Accordingly, the decision appealed from is reversed, and the surety bond filed to guarantee payment of said assessment is ordered cancelled. No pronouncement as to costs."

Norton and Harrison is a corporation organized in 1911, (1) to buy and sell at wholesale and retail, all kinds of goods, wares, and merchandise; (2) to act as agents of manufacturers in the United States and foreign countries; and (3) to carry on and conduct a general wholesale and retail mercantile establishment in the Philippines. Jackbilt is, likewise, a corporation organized on February 16, 1918 primarily for the purpose of making, producing and manufacturing concrete blocks. Under date of July 27, 1948, Norton and Jackbilt entered into an agreement whereby Norton was made the sole and exclusive distributor of concrete blocks manufactured by Jackbilt, Pursuant to Commissioner of Internal Revenue vs. Norton Harrison Co. this agreement, whenever an order for concrete blocks was received by the Norton & Harrison Co. from a customer the order was transmitted to Jackbilt which delivered the merchandise direct to the customer. Payment for the good is, however, made to Norton, which in turn pays Jackbilt the amount charged the customer less a certain amount, as its compensation or profit. To exemplify the sales procedures adopted by the Norton and Jackbilt. the following may be cited. In the case of the sale of 420 pieces of concrete blocks to the American Builders on April 1, 1952, the purchaser paid to Norton the sum of P189.00 the purchase price. Out of this amount Notion paid Jackbilt P168.00, the difference obviously being its compensation. As per records of Jackbilt the transaction was considered a sale to Norton. It was under this procedure that the sale of concrete blocks manufactured by Jackbilt wag conducted until May 1, 1953, when the agency agreement was terminated and a management agreement between the parties was entered into. The management agreement provided that Norton would sell concrete blocks for Jackbilt, for a fixed monthly management fee of P2,000.00, which was later increased to P5,000.00.

During the existence of the distribution or agency agreement, or on June 10, 1949, Norton & Harrison acquired by purchase all the outstanding shares of stock of Jackbilt. Apparently, due to this transaction, the Commissioner of Internal Revenue, after conducting an investigation, assessed the respondent Norton & Harrison for deficiency sales tax and surcharges in the amount of P32,662.99, making as basis thereof the sales of Norton to the public. In other words, the Commissioner considered the sale of Norton to the public as the original sale and not the transaction from Jackbilt. The period covered by the assessment was from July 1, 1919 to May 31, 1953. As Norton and Harrison did not con form with the assessment, the matter was brought to the Court of Tax Appeals.

The Commissioner of Internal Revenue contends that since Jackbilt was owned and controlled by Norton & Harrison, the corporate personality of the former (Jackbilt) should be disregarded for sales tax purposes, and the sale of Jackbilt blocks by petitioner to the public must be considered as the original sales from which the sales tax should be computed. The Norton & Harrison Company contended otherwise—that is, the transaction subject to tax is the sale from Jackbilt to Norton.

The majority of the Tax Court, in relieving Norton and Harrison of liability under the assessment, made the following observations:

"The law applicable to the case is Section 186 of the National Internal Revenue Code which imposes a percentage tax of 7% on every original sale of goods, wares or merchandise, such tax to be based on the gross selling price of such goods, wares or merchandise. The term original sale has been defined as the first sale by every manufacturer, producer or importer. (Sec. 5, Com. Act No. 503). Subsequent sales by persons other than the Manufacturer, producer or importer are not subject to the sales tax.

If JACKBILT actually sold concrete blocks manufactured by it to petitioner under the distributorship or agency agreement of July 27, 1948, such sales constituted the original sales which are taxable under Section 186 of the Revenue Code, while the sales made to the public by petitioner are subsequent sales which are not taxable. But it appears to us that there was no such sale by JACKBILT to petitioner. Petitioner merely acted as agent for JACKBILT in the marketing of its products. This is shown by the fact that petitioner merely accepted orders from the public for the purchase of JACKBILT blocks. The purchase orders were transmitted to JACKBILT which delivered the blocks to the purchaser directly. There was no instance in which the blocks ordered by the purchasers were delivered to the petitioner. Petitioner never purchased concrete blocks from JACKBILT so that it never acquired ownership of such concrete blocks. This being so, petitioner could not have sold JACKBILT blocks for its own account. It did so merely as agent of JACKBILT. The distributorship agreement of July 27, 1948, is denominated by the parties themselves as an 'agent for marketing' JACKBILT products. * * *.

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Therefore, the taxable selling price of JACKBILT blocks under the aforesaid agreement is the price charged to the public and not the amount billed by JACKBILT to petitioner. The deficiency sales tax should have been assessed against JACKBILT and not against petitioner which merely acted as the former's agent.

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Presiding Judge Nabie of the same Court expressed a partial dissent, stating:

"Upon the aforesaid circumstances, which disclose Norton's control over and direction of Jackbilt's affairs, the corporate personality of Jackbilt should be disregarded, and the transactions between these two corporations relative to the concrete blocks should be ignored in determining the percentage tax for which Norton is liable. Consequently, the percentage tax should be computed on the basis of the sales of Jackbilt blocks to the public."

The majority opinion is now before Us on appeal by the Commissioner of Internal Revenue, on four (4) assigned errors, all of which pose the following propositions: (1) whether the acquisition of all the stocks of also Jackbilt by the Norton & Harrison Co., merged the two corporations into a single corporation; (2) whether the basis of the computation of the deficiency sales tax should be the sale of the blocks to the public and not to Norton.

It has been settled that the ownership of all the stocks of a corporation by another corporation does not necessarily breed an identity of a corporate interest between the companies and be considered as a sufficient ground for disregarding the distinct personalities (*Liddell & Co., Inc. vs. Coll. of Int. Rev.* L-9687, June 30, 1961).

However, in the case at bar, we find sufficient grounds to support the theory that the separate identities of the two companies should be disregarded. Among these circumstances, which we find not successfully refuted by appellee Norton are: (a) Norton and Harrison own all the outstanding stocks of the Jackbilt: of the 15,000 authorized shares of Jackbilt on March 31, 1958, 14,998 shares belonged to Norton and Harrison and one each to seven others, (b) Norton constituted Jackbilt's board of directors in such a way as to enable it to actually direct and manage the other's affairs by making the same officers of the board for both companies. For instance, James E. Norton is the President, Treasurer, Director and Stockholder of Norton. He also occupies the same positions in the Jackbilt corporation, the only change being, in the Jackbilt, he is merely a nominal stockholder. The same is true with M. Jordan, F. M. Domingo, M. Mantaring, Gilbert Golden and Gerardo Garcia, while they are merely employees of the Norton, they are Directors and nominal stockholders of the Jackbilt; (c) Norton financed the operations of the Jackbilt, and this is shown by the fact that the loans obtained from the RFC and Bank of America were used in the expansion program of Jackbilt, to pay advances for the purchase of equipment, materials, rations and salaries of employees of Jackbilt and other sundry expenses. There was no limit to the advances given to Jackbilt, so much so that as of May 31, 1956, the unpaid advances amounted to P757,652.45, which were not paid in cash by Jackbilt, but was offset by shares of stock issued to Norton the absolute and sole owner of Jackbilt; (d) Norton treats Jackbilt employees as its own. Evidence shows that Norton paid the salaries of Jackbilt employees and gave the same privileges as Norton employees, an indication that Jackbilt employees were also Norton's employees. Furthermore, service rendered in anyone of the two companies were taken into account for purposes of promotion; (e) Compensation given to board members of Jackbilt, who are also board members and or employees of Norton, indicate that Jackbilt is merely a department of Norton. The income tax return of Norton for 1954 shows that as President and Treasurer of Norton and Jackbilt he received from Norton P56,929.95, but received from Jackbilt the measly amount of P150.00, a circumstance which points out that remunerations of purported officials of Jackbilt are deemed included in the salaries they received from Norton. The same is true in the case of Eduardo Garcia, an employee of Norton but a member of the Board of Jackbilt. His income tax return for 1956 reveals that he received from Norton in salaries and bonuses P4,220.00, but received from Jackbilt, by way of entertainment, representation, traveling and transportation allowances P3,000.00. However, in the withholding statement (Exh. 28-A), it was shown that the total of P4,220.00 and P3,000.00 (P7,220.00) was received by Garcia from Norton, thus portraying the oneness of the two companies. The Income Tax Returns of Albert Golden and Dioscoro Ramos, both employees of Norton but board members of Jackbilt also disclose the same method of payment of compensation and allowances. The offices of Norton and Jackbilt are located in the same compound. Payments were effected by Norton of accounts for Jackbilt and vice versa. Payments were also made to Norton of accounts due or payable to Jackbilt and vice versa.

Norton and Harrison, while not denying the presence of the set up stated above, tried to explain that the control over the affairs of Jackbilt was not made in order to evade payment of taxes; that the loans obtained by it which were given to Jackbilt, were necessary for the expansion of its business in the manufacture of concrete blocks, which would ultimately benefit both corporations; that the transactions and practices just mentioned, are not unusual and extraordinary, but pursued in the regular course of business and trade; that there could be no confusion in the present set up of two corporations, because they have separate Boards, their cash assets are entirely and strictly separate; cashiers and official receipts and bank accounts are distinct and different; they have separate income tax returns, separate balance sheets and profit and loss statements. These explanations notwithstanding, an over all appraisal of the circumstances presented by the facts of the case, yields to the conclusion that the Jackbilt is merely an adjunct, business conduit or alter ego, of Norton and Harrison and that the fiction of corporate entities, separate and distinct from each, should be disregarded. This is a case where the doctrine of piercing the veil of corporate fiction, should be made to apply. In the case of *Liddell & Co. Inc. vs. Coll. of Int. Rev.*, supra, it was held:

"There are quite a series of conspicuous circumstances that militates against the separate and distinct personality of Liddell Motors Inc. from Liddell & Co. 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. its a matter of formality.

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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 sequence of the organization and activities of Liddell Motors, Inc.

As opined in the case of Gregory v. Helvering, "the legal right of a tax payer 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, "where a corporation is a dummy, is unreal or a sham and serve 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 a mischievous fiction".

"* * * 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 benefits of the transactions as the person accordingly taxable.

"* * * to allow a taxpayer to dodge 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." (and cases cited therein).

In the case of Yutivo Sons Hardware Co. vs. Court of Tax Appeals, 110 Phil., 75], this Court made a similar ruling where the circumstances of unity of corporate identities have been shown and which are identical to those obtaining in the case under consideration. Therein, this Court said:

"We are, however, inclined to agree with the Court below that SM was actually owned and controlled by petitioner as to make it a mere subsidiary or branch of the latter created for the purpose of selling the vehicles at retail (here concrete blocks) * * *."

It may not be amiss to state in this connection, the advantages to Norton in maintaining a semblance of separate entities. If the income of Norton would be considered separate from the income of Jackbilt, then each could declare such earnings separately for income tax purposes and thus pay lesser income tax. The combined taxable Norton Jackbilt income would subject Norton to a higher tax. Based upon the 1954-1955 income tax return of Norton and Jackbilt (Exh. 7 & 8), and assuming that both of them are operating on the same fiscal basis and their returns are accurate, we would have the following result: Jackbilt declared a taxable net income of P161,202.31 in which the income tax due was computed at P37,137.00 (Exh. 8); whereas Norton declared as taxable, a net income of P120,101.59, on which the income tax due was computed at P25,628.00. The total of these liabilities is P50,764.84. On the other hand, if the not taxable earnings of both corporations are combined, during the same taxable year, the tax due on their total which is P281,303.90 would be P70,764.00. So that, even on the question of income tax alone, it would be to the advantage of Norton that the corporations should be regarded as separate entities.

Wherefore, the decision appealed from should be as it is hereby reversed and another entered making the appellee

Norton and Harrison liable for the deficiency sales taxes assessed against it by the appellant Commissioner of Internal Revenue, plus 25% surcharge thereon. Costs against appellee Norton & Harrison.

Bengzon, C. J., Bautista Angelo, Concepcion, Reyes, J. B. L., Regala and Makalintal, J.J., concur.

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