PHILIPPINE AMUSEMENT ENTERPRISES,
INC.,
Petitioner,

- versus -

C.T.A.
CASE NO. 718

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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D E C I S I O N

This is an appeal from the decision of respondent assessing against and demanding from petitioner the payment of the sum of ₱62,529.00 as deficiency sales tax, surcharge and penalty for the period from 1953 to the first quarter of 1956.

Petitioner Philippine Amusement Enterprises, Inc. is a domestic corporation organized in 1950 primarily to engage, among others, in the assembly, manufacture, sale and lease of coin-operated machines and devices (see Exh. 2-A-1). It engaged in business with an original capitalization of ₱200,000.00 divided into 200,000 shares at a par value of ₱1.00, but of which 40,000 shares were actually subscribed. Of the subscribed shares of 40,000, John W. Spakowski owned 39,497 shares.

In 1953, the Music Corporation of the Philippines (hereinafter referred to as MCP) was organized for the same purpose as petitioner, e.g., the assembly, manufacture, lease and/or sale of coin-operated machines and devices (see Exh. 1-A-1; 1-A-2). This corporation was capitalized at ₱25,000 divided into 25,000 shares at a par value of ₱1.00. Of the subscribed shares which totalled 5,000, John W. Spakowski owned 4,941 shares.

During the years under review, both corporations were managed by the same set of officers, headed by John W. Spakowski, as President (Exhs. 1-A-11 to 1-A-22; Exhs. 2-A-23 to 2-A-26), and directors (Exhs. 1-A-6 to 1-A-11; Exhs. 2-A-9 to 2-A-13). They had a common office, common auditor, common accountant and common bookkeeper (Exh. 3-A; pp. 122-123, Exh. 3-A-5). The majority stockholding in both corporations had always been in the hands of John W. Spakowski who owned no less than 99% of the stocks (Exhs. 1-A-4; Exh. 2-A-4; Exh. 2-A-4 (a)).

During the taxable year 1953 to the first quarter of 1956, petitioner assembled and manufactured juke boxes which, except a few that were directly sold to individual buyers at a price much higher (by about ₱400.00) (p. 144, t.s.n., Hearing: Jan. 24, 1961), were sold to the MCP, which, in turn either first leased the juke boxes and then sold them to its customers, or sold them outright to the general public.

Treating the sales of its assembled or manufactured juke boxes to MCP as the original sales, petitioner paid the 30% sales tax thereon. However, respondent, believing that MCP is a mere subsidiary, adjunct, instrumentality, conduit or an <u>alter ego</u> of petitioner created for the purpose of evading taxes, considered the sales of MCP to the public as the taxable sales. In short, respondent disregarded the corporate personality of MCP insofar as the sales by petitioner of juke boxes to it from 1953 to the first quarter of 1956 are concerned. Consequently, respondent issued a deficiency sales tax assessment against petitioner in the sum of ₱62,529.00, inclusive of surcharge and penalty, for the period from 1953 to the first quarter of 1956, computed as follows:

Total sales thru Music Corporation	₱ 559,682.50
Less: Cost of sales	411,965.86
Amount still subject to tax	147,716.64
30% tax due thereon	₱ 44,314.99
Less: Taxes paid	9,155.56
Deficiency sales tax	35,159.43
Add: 25% surcharge for late payment	8,789.86
50% surcharge for fraudulent manipulations of sales transactions	17,579.71
Penalty	1,000.00
TOTAL AMOUNT DUE	₱ 62,529.00

(Exh. 3, BIR rec., p. 31)

A request for reconsideration of the assessment having been denied, petitioner appealed to this Court.

The only issue in this case is whether or not the Music Corporation of the Philippines (MCP) is merely a subsidiary, adjunct, instrumentality, conduit or *alter ego* of petitioner.

It is contended by petitioner that the MCP is a corporation distinct and separate from petitioner and was not organized as a mere retail outlet or *alter ego* of petitioner for tax evasion. On the other hand, respondent insists the contrary.

We agree with respondent. MCP is a mere alter ego of petitioner with regards to the sales made by the latter to the former. This conclusion is borne by the facts of the case. The facts show that during the period under review, John W. Spakowski owned 99% of the subscribed stocks of petitioner corporation and MCP; that these corporations had the same sets of officers and directors, the former headed by a common president, John W. Spakowski; and that these corporations had a common office, common auditor, common accountant and common bookkeeper. Under the set up of petitioner and MCP, it is not difficult to discern a common control over their business, financial and management policies for desired ends. Although it is a general rule that sale transactions between related corporations are recognized as valid, yet where such sales are not bona fide or at arms length, they ought to be entirely disregarded. In the case at bar, we find that the price of the juke boxes sold by petitioner to MCP is much lower than when they are sold to the public. The difference between the cost of sales to MCP and the sales of the latter to the public is substantial. (Exhs. 3-A-2 & 3-A-3). A substantial profit accrued to MCP notwithstanding that the jukeboxes purchased by it from petitioner were first leased and then subsequently sold to the public. Obviously, the sales between petitioner and MCP were not bona fide or at arms length. Transactions, as well as the corporate personalities of corporations, ought to be disregarded by taxing authorities where to do so shall insure the protection of the interest of a third person, in this case the government. (Koppel (Phil.) Inc. vs. Yatco, 77 Phil. 496, 506; Liddell & Co., Inc. vs. Collector, G.R. L-9687, June 30, 1961; Yutivo Sons Hardware Co. vs. Court of Tax Appeals, et al., G.R. No. L-13203, Jan. 28, 1961. Consequently, the sales of juke boxes made by MCP to the public should be considered as petitioner's taxable sales.

Petitioner's assertion that MCP is a distinct corporation from petitioner as it engaged in other lines of business in which the latter is not engaged is without merit. MCP engaged in the distribution and sale of other products only after the period under review. Its business transactions were then limited to one line of business, that is, the purchase, lease and sale of juke boxes mostly obtained from petitioner.

The 50% penalty imposed by respondent for alleged fraudulent manipulations of sales transactions by petitioner is not warranted because there was a full disclosure of petitioner's transactions. Petitioner's sales to MCP of juke boxes were embodied in its tax returns. Hence, it cannot be charged that petitioner deliberately made a false return for the purpose of defrauding the government of its revenue. However, it is liable for 25% surcharge for late payment (Liddell & Co., Inc. vs. Collector, supra; Yutivo Sons Hardware Co. vs. C.T.A., supra).

Finally, with respect to the compromise penalty of ₱1,000.00, it is well settled that this penalty cannot be adjudged without the consent of the taxpayer. (Central Azucarera de Tarlac v. Coll. of Int. Rev., C.T.A. Case No. 206, Oct. 15, 1956 affd. in G.R. Nos. L-11760 & L-11761, July 31, 1958; Western Mindanao Lumber v. Coll. of Int. Rev., C.T.A. Case No. 223, Oct. 27, 1956, affd. in G.R. No. L-11710, June 30, 1958.)

IN VIEW OF THE FOREGOING CONSIDERATIONS, the decision appealed from should be as it is hereby modified. Petitioner is liable for and is hereby ordered to pay respondent the amount of ₱43,949.29 as deficiency sales tax for the years 1953 to the first quarter of 1956, computed as follows:

Total sales thru Music Corporation ....₱	559,682.50
Less: Cost of sales	411,965.86
Amount still subject to tax ....₱	147,716.64
30% tax due thereon ....₱	44,314.99
Less: Taxes paid	9,155.56
Deficiency sales tax ....₱	35,159.43
Add: 25% surcharge for late payment	8,789.86
TOTAL AMOUNT DUE ....₱	43,949.29

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without pronouncement as to costs.

SO ORDERED.

Manila, January 25, 1964.

MARIANO NABLE
Presiding Judge

I CONCUR:

AUGUSTO M. LUCIANO
Associate Judge

Associate Judge Roman M. Umali did not take part.