lit.

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PAPER INDUSTRIES CORPORATION
OF THE PHILIPPINES AND BISLIG
BAY LUMBER CO., INC.,
Petitioners,

- versus - C.T.A. CASE NO. 2402

COMMISSIONER OF INTERNAL
REVENUE,
Respondent. 9/15/74

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D E C I S I O N

In this appeal from the decision of respondent Commissioner of Internal Revenue holding petitioners Paper Industries Corporation of the Philippines (hereinafter referred to as PICOP) and Bislig Bay Lumber Co., Inc., (hereinafter referred to as "Bislig") liable for the amounts of ₱1,294,097.23 and ₱2,028,790.00, respectively, as withholding tax for the years 1968, 1969 and 1970, the pivotal and decisive issue is whether the International Wood Products, Ltd., (hereinafter referred to as "IWP"), a nonresident foreign corporation existing by virtue of and under the laws of Hongkong realized "fixed or determinable annual or periodical or casual" income from sources within the Philippines during these years within the meaning of Sections 24(b)

(1), 53 and 54 of the National Internal Revenue Code. Respondent on the basis that the agency commissions paid and remitted abroad by petitioners to IWP constitute income from sources within the Philippines under Section 37 of the Tax Code, held that the said income is subject to Philippine income tax pursuant to Section 24(b) of the said Code, as amended. And since these commissions are fixed and determinable income of IWP, the income tax due thereon should be withheld in accordance with Section 54, in relation to Section 24, of the Code.

And as a corollary thereto, whether or not the subsequent examination of the books of accounts and accounting records of petitioners in 1972 by respondent, that gave rise to the disputed assessments in the instant case, was barred by the prior 1971 investigation, because of the prohibition contained in Section 337 of the Tax Code against multiple examination of a taxpayer within a period of five years.

There is no dispute as to the facts, the same having been either substantially admitted or borne out by the records. As narrated by respondent, it appears that:

Petitioners are domestic corporations organized and existing under the laws of the Philippines with principal offices in the 8th Floor, A. Soriano Bldg., 8776 Paseo de Roxas, Makati, Rizal, engaged in the business of exporting logs. Sometime in 1972, Bislig was merged with PICOP and was dissolved as a corporation.

On March 22, 1968, each of the petitioners executed in Makati, Rizal, an agency agreement with International Wood Products, Ltd. (IWP for short), a Hongkong corporation non-resident in the Philippines, appointing the latter as their exclusive agent to sell logs in Taiwan, Okinawa, Japan, Korea, United States and elsewhere. The said agency agreements were drafted in identical terms. Quoted hereunder is that executed with PICOP which reads:

> "WHEREAS, INTERNATIONAL has contacts with buyers for Philippine logs in the United States, Formosa, Japan and elsewhere and has the necessary facilities to promote and increase the sale of PICOP logs in the world markets;
>
> "WHEREAS, PICOP finds it to its best interest to market through INTERNATIONAL all logs available for export out of PICOP's total log production after deducting its own requirement for its pulp and paper mill and timber processing in Surigao del Sur;
>
> "NOW, THEREFORE, for and in consideration of the premises and of the mutual promises, covenants and stipulations herein contained, the parties hereto do hereby agree, the one with the other, as follows:
>
> 1. PICOP hereby appoints INTERNATIONAL as its sole and exclusive Sales Agent to handle the sale of its export logs to the United States of America,

Formosa, Japan, Europe and elsewhere in the world and INTERNATIONAL hereby accepts its appointment as such Sales Agent of PICOP.

2. INTERNATIONAL shall, at its own expense, carry out and engage in maximum sales exploitation under this Agreement in conjunction with PICOP and its representatives and shall obtain maximum sales of PICOP's logs throughout the world market under contracts satisfactory to PICOP.

3. INTERNATIONAL shall, likewise, at its own expense, unless otherwise provided, protect and promote the interest, good name and reputation of PICOP and shall employ such suitably qualified personnel as may be reasonably required to obtain maximum sales exploitation of PICOP's logs under this Agreement.

4. INTERNATIONAL shall exert its best efforts to obtain the most favorably prices for PICOP on a C and I basis, in no case lower than current market prices.

5. INTERNATIONAL shall assist PICOP in its execution of existing and future contracts, both before and after delivery of logs to the customer, and shall obtain and report regularly to PICOP information, statistics and data of -

a. the log market conditions throughout the world;

b. the general political and economic conditions throughout the world.

6. For its services hereunder, PICOP will pay INTERNATIONAL a commission based on the following schedule:

a. Sales to any areas throughout the world, except Japan:	5% based on the FOB, Bislig, value

(b) Sales to Japan: For the first 1,770 cubic meters sold during any month, 5% on FOB value Bislig

For the second 1,770 cubic meters sold during the month, 4% on FOB value Bislig

For any sale over 3,540 cubic meters during the month, 3% on FOB value Bislig

7. Commissions due INTERNATIONAL under this agreement shall be payable in U.S. currency in Hongkong. It is understood that any tax that may hereafter be imposed by the Philippine Government on such remittances will be for the account of PICOP. The parties shall abide by foreign exchange laws and regulations of the Republic of the Philippines." (Underscoring supplied)

Sometime in February 1972, respondent, acting on a confidential information filed with his Office, caused the investigation of the petitioners on their failure to withhold the tax on the commissions remitted to IWP for the years 1968 to 1970. The investigating examiners were, however, not given access to the records of both PICOP and Bislig and, therefore, had to resort to other evidences such as the Financial Statements of the petitioners as well as the decision of the Supreme Court of Hongkong in the case of the Commissioner of Inland Revenue vs. International Wood Products, Ltd., in Inland Revenue Appeal No. 2 of 1971. (t.s.n. pp. 64-65).

As a result of the aforesaid investigation, petitioners, on April 13, 1972, were issued deficiency withholding tax assessments for the years 1968 to 1970 as follows:

BBLC	1968	1969	1970
Gross commissions	₱1,638,986.80	₱1,125,559.22	₱2,174,671.02
30% tax thereon	491,696.00	337,668.00	793,668.00
25% penalty	122,924.00	84,417.00	198,417.00
	₱ 614,620.00	₱ 422,085.00	₱ 992,085.00

PICOP			
Gross commissions	₱ 1,205,084.65	₱ 1,079,703.00	₱ 1,164,985.60
30% tax thereon	361,525.00	323,911.00	349,496.00
25% penalty	90,813.48	80,977.75	87,374.00
	₱ 452,338.48	₱ 404,888.75	₱ 436,870.00

These assessments were protested by petitioners' counsel on April 19, 1972, which protest was, however, denied by respondent in a letter dated April 21, 1972.

Hence, this appeal. (Pp. 254-257, CTA records.)

After carefully examining all the legal provisions, cases and authorities cited in the memorandums submitted to the Court, we are convinced that despite the seemingly conflicting rulings and decisions invoked by the parties in support of their respective positions, there is no quarrel between them on the basic principles by which the liability or non-liability of petitioners for the deficiency withholding tax assessed against them on account of their failure to withold and pay to respondent the income tax on the agency commissions earned by and remitted to their sales agent, the International Wood Products, Ltd., is to be resolved. It will help simplify matters if these provisions of law, rulings and authorities, in the light of their applicability to the particular facts of the instant case, are reduced to basic legal propositions that are beyond dispute, to wit:

1. As explicity provided by both statute and regulations, the gross income of a non-resident foreign corporation subject to tax consists of its gross income from sources within the Philippines. (Sec. 24(b)(1), Tax Code; Sec. 60, Rev. Regs. No.2). International Wood Products, Ltd. (IWP), being a non-resident foreign corporation, its gross income subject to income tax under Philippine law consists of its gross income from sources within the Philippines.

2. Compensation for labor or personal services constitutes gross income from sources within the Philippines if the labor or personal services are performed within the Philippines, regardless of the residence of the payor, of the place in which the contract for service was made, or of the place of payment. (Sec. 37(a)(3), Tax Code; Sec. 155, Rev. Regs. No. 2). Conversely, compensation for labor

or personal services performed without the Philippines constitutes income from sources without the Philippines. (Sec. 37(c)(3), Tax Code; Sec. 158(3), Rev. Regs. No. 2). It follows that if the agency commissions in question paid by petitioners to IWP are for services rendered as their agent in the sale of logs abroad, the services should have been performed in the Philippines in order that the same are taxable under Philippine income tax law.

3. The general rule is that income derived from the purchase and sale of personal property is treated as derived entirely from the country in which sold. (Sec. 37(a)(b), Tax Code; Sec. 159, Rev. Regs. No. 2.) Assuming that the agency commissions paid by petitioners to IWP are in the nature of profits from the sale of logs, IWP, which is admittedly a non-resident foreign corporation, would then be classified as a resident foreign corporation engaged in trade or business (of agency in the sale of logs) in the Philippines in order that such profits (or commissions) would be taxable under our income tax law. (See Vol. 3, 1965 Federal Taxes, par. 16,295-C).

4. The law requires that every individual, person or corporation, in whatever capacity acting, having the control or payment of compensation or other

fixed or determinable annual of periodical or casual gains, profits and income of foreign corporations subject to income tax not engaged in trade or business within the Philippines, to deduct and withhold from such income the tax due thereon, file the requisite withholding return and pay the tax withheld to the Bureau of Internal Revenue. (Secs. 53(b)(c), 54; Sec. 205, Rev. Regs. No. 2.) In effect, therefore, if the agency commissions received by IWP are subject to income tax, the responsibility for the collection of the tax as well as the payment thereof is concentrated upon petitioners over whom the Government has jurisdiction.

In this backdrop, our first inquiry must necessarily be directed to the actual source of the income of IWP, which respondent seeks to tax as being from sources within the Philippines.

Petitioners' contention is, in substance, that the agency commissions received by IWP, which are sought to be taxed, were for services performed under its contracts of agency with them. Since all the acts and services performed in accordance with the agency contracts were rendered outside the Philippines, the source of the income of IWP are from sources outside of the Philippines. The said commissions are not therefore subject to Philippine income tax pursuant to Section 24(b) of the Tax Code, according to petitioners, because IWP, being a non-resident foreign corporation, its gross income subject to tax consists only of its gross income from sources within the Philippines.

In brushing aside this stand of petitioners, respondent alleges that "IWP merely receives the percentage commission everytime the sales of logs are effected without rendering any service. This is so because IWP is a sister company of the petitioners and, as a matter of fact, the majority members of IWP's Board of Directors are also the majority members of the petitioners' Board of Directors." (p. 258, CTA rec.) And averring that since "the sales were consummated in the Philippines, the selling arrangement being F.O.B. Bislig, it necessary follows that the income that were generated from the transactions, i.e., gross income on the part of the sellers (petitioners) and commissions on the part of agent (IWP) should be declarable in the Philippines" (p.259, CTA rec.); meaning probably, from profits derived from the sale of logs in the Philippines by petitioners which should be treated as derived entirely from Philippine sources.

By this argument, respondent would seem to suggest that the agency contracts entered into by petitioners and IWP, appointing the latter as their exclusive agent to sell logs in Taiwan, Okinawa, Japan, Korea, United States and elsewhere, were merely profit-sharing arrangements with the agency commissions given to IWP in the nature of its share in the profits derived from the trade or business of selling logs. Unless, of course, respondent would want this Court to look beyond the corporate form of petitioners and/or IWP and ignore the separate entities of the corporations, with the latter being but a part of the former acting merely as their alter ego, conduit or subsidiary.

The records provide no basis for such an interpretation, much less conclusion, which is evidently in conflict with respondent's own admission (par. 8, Special and Affirmative Defenses, Respondent's Answer) and his above-quoted statement of facts that IWP was "a Hongkong (foreign) corporation non-resident in the Philippines", which means undoubtedly that it was not engaged in trade or business in the

Philippines during the period in question. IWP, being admittedly a non-resident foreign corporation, it is taxed only on "interest, dividends, rents, salaries, wages, premiums, annuities, compensations, renumerations, emoluments, or other fixed or determinable annual or periodical or casual gains, profits and income and capital gains" (Sec. 24(b)(1), Tax Code), from sources within the Philippines, and profit from the trade or business of selling personal property within the Philippines does not apparently come within this enumeration or classification. Acting as agent in the sale of property in the Philippines would readily constitute "engaging in trade or business within the Philippines" with the result that IWP would have to be classified as a resident foreign corporation engaged in trade or business in the Philippines for such profit (commissions) to be taxable under our income tax law.(See Vol. 3, 1965 Federal Taxes, par. 16,295-C.) Moreover, it seems clear that IWP's income which respondent seeks to tax consisted of agency commissions remitted to it by petitioners (Special and Affirmative Defenses, Respondent's Answer) was in no way related to the profits realized by petitioners from the sale of logs to their foreign buyers which, in accordance with the agency contracts entered into between them, were measured, depending upon the country where sold, by a fixed percentage of gross sales.

And in the circumstance that "the majority members of IWP's Board of Directors are also the majority members of the petitioners' Board of Directors" (p. 258, CTA records), we cannot, on that basis alone, hold that IWP was merely an alter ego, conduit or extension of petitioners. Aside from the admission of respondent that IWP is a non-resident foreign corporation, it is an elementary principle of corporation law that a corporation is an entity separate and distinct from its stockholders and from other corporations to which it may be connected. No evidence whatever was presented here by respondent that the notion of corporate entity was used as a device to defeat public convenience or defraud the Government of lawful revenue to justify disregard of corporate identity. A taxpayer is free to choose the form in which he will do business, and if, having chosen a form, he actually carries on the business under the structure adopted, the government cannot deprive him of the benefit of the chosen form, except upon a showing that the form is unreal or sham. (Higgins v. Smith, 308 U.S. 473.) From this focal point, we cannot therefore extract a view that the agency commissions paid by petitioners to IWP were profits realized from the sale of logs attributable to sources within the Philippines under Section 37(a)(b) of the Revenue Code.

It seems clear in the present case that the commissions paid by petitioners to IWP were compensation for services rendered as their agent in the sale of logs in Korea, Japan, Taiwan and other foreign countries. By the contracts of agency (Exhibits "A" and "B") entered into by and between petitioners and IWP, the latter bound itself to render the following services for and on behalf of the former:

(a) Handle the sale of export logs in America, Taiwan, Japan, Europe and elsewhere in the world;

(b) Maximize, at its own expense, the sales exploitation to export logs throughout the world market;

(c) Protect and promote the interest, good name and reputation of petitioners to obtain máximum sales exploitation of the logs of petitioners;

(d) Exert best efforts to obtain the most favorable prices not lower than current market prices; and

(e) Assist petitioners in the execution of existing and future contracts, and obtain and report regularly to petitioners on information and data affecting log market conditions and general political and economic world conditions.

To perform and accomplish these services for petitioners, IWP had to establish a sales force by appointing sub-agents in Korea, Japan and Taiwan, who had their own prospects or contacts in need of logs to buy for use in their respective plywood and lumber manufacturing plants. These sub-agents, which constituted the sales facilities of IWP, contacted their prospects (or the latter contacted them), informing these prospects of the availability of logs at a particular time, the volume, kind and grade, the price per cubic meter, and inquired if the prospect was interested to buy. Often, it was the prospect who contacted these sub-agents, asking of the availability and price quotations of the desired logs in desired volumes. When the sub-agent and buyer reached an agreement, the former prepared the "acknowledgment of order" or "confirmation of order" or "offer sheet." All of these were signed by the sub-agents on behalf of IWP. A copy of this acknowledgment of order or confirmation of order or offer sheet is sent to IWP in Hongkong, and another copy to Picop or Bislig as the case may be. As soon as the buyer approved such order, it immediately opened letters of credit in favor of Picop or Bislig, until 1969 and in favor of IWP, beginning January 1970.

On the basis of the purchase orders, called either acknowledgment of order or confirmation of order, received by Picop and Bislig, these suppliers prepared the manufacturing orders. In turn, these manufacturing orders became the authority for shipping the required volume and specification of logs ordered. It appears that the buyers then took delivery upon arrival of the logs in their respective ports.

The records show that in December 1969, each of the petitioners and IWP entered into a contract terminating the sales agency relationship. Effective January 1, 1970, IWP was instead converted into an exclusive buyer of all the logs of Picop and Bislig. IWP, as of that date, ceased to be a sales agent of Picop and Bislig.

For services rendered in the sale of the logs of petitioners to foreign buyers and for performing all the acts and services which it bound itself to render under the agency contracts, IWP received agency commissions from the former. During the trial of this case, petitioners through their independent auditors and through the chartered accountant of IWP in Hongkong presented evidence as to the exact amount earned by IWP as agency commissions. The Philippine independent auditors and the Hongkong chartered accountants, Peat, Marwick, Mitchell & Co. Ltd., confirmed respectively by verified certifications and testimony in court in the case of the Philippine auditors, Sycip, Gorres, Velayo & Co., that the figures shown below in United States dollars were accrued respectively by petitioners and IMP in their books as agency commissions earned by the latter, pursuant to the agency contracts entered into by them:

P I C O P			B I S L I G B A Y	
Per SGV & Co.	Per Peat, Marwick		Per SGV & CO.	Per Peat, Marwick
		1968		
U.S.$35,080.57	U.S.$35,080.57	March	U.S. $31,014.41	$31,069.47
11,740.60	11,740.60	April	17,852.63	17,852.63
5,685.30	5,685.30	May	51,049.39	52,381.42
16,491.48	16,491.48	June	26,787.11	28,175.93
16,528.54	16,528.54	July	31,654.10	32,851.83
23,861.56	23,861.56	August	29,804.03	31,048.44
21,406.89	21,406.89	Sept.	37,566.61	32,348.73
16,059.63	16,059.63	Oct.	17,318.03	17,318.03
28,157.39	28,209.76	November	44,464.24	44,464.10
17,429.36	17,376.99	December	25,539.87	25,539.87
		1969		
12,656.51	12,655.51	January	17,671.87	17,671.87
15,623.97	15,623.97	February	19,686.99	19,686.99
U.S.$220,721.80	U.S.$220,721.80		U.S. $350,409.28	$350,409.28
U.S.$14,091.58	14,091.58	March	$ 15,790.03	15,790.03
16,190.62	16,190.62	April	23,005.15	23,005.15
17,689.86	17,689.86	May	20,576.62	20,576.62
11,176.54	11,176.54	June	35,519.00	35,519.00
10,848.45	10,848.45	July	25,940.42	25,940.42
18,365.13	18,365.13	August	40,602.75	40,602.75
18,590.96	18,590.96	Sept.	39,214.97	39,214.97
15,208.16	15,208.16	Oct.	40,518.45	40,518.45
12,898.52	12,898.52	November	33,571.82	33,571.82
13,143.13	13,143.13	December	43,540.93	43,540.93

1970*

nil	nil	January	nil	nil
nil	nil	February	nil	nil
U.S.$148,202.95	$148,202.95		U.S. $318,280.14	U.S.$318,280.14
Total -				
U.S.$368,924.75	$ 368,924.75		U.S. $668,689.42	U.S.$668,689.42

* In 1970, no agency commissions were accrued for in that year, IWP ceased to be a commission agent.

As we have already stated above, all the acts and services of IWP which it bound itself to render for and on behalf of petitioners under the agency contracts, and for which it was paid agency commissions, were all performed in Korea, Japan and Taiwan, or outside the Philippines. The important factor therefore which determines the source of income is not the residence of the payor, or the place where the contract for services is entered into, or the place of payment, but the place where the services were actually rendered. (Sec. 155, Rev. Regs. No. 2; 8 Mertens Law of Federal Income Taxation 45.33, p. 82.) Since compensation for labor or personal services performed without the Philippines is income from sources without the Philippines (Sec. 37(c)(3), Tax Code; Sec. 158, Rev. Regs. No. 2), IWP's agency commissions which arose out of its acts and services rendered in Korea, Japan and Taiwan are "compensation for labor or personal services performed without the Philippines." Consequently, such agency commissions are, under the plain provision of the law" income from sources without the Philippines."

Although IWP's commissions might have been the result of the sale of the logs of petitioners to their foreign buyers, it does not necessarily follow that the profit of petitioners from such sale constituted the source of its income. Respondent admits that IWP is a non-resident foreign corporation, and what is being sought to be taxed, through petitioners' liability to pay withholding tax-at source, are IWP's commissions for services rendered in the sale of petitioners' logs to foreign buyers. Being a non-resident foreign corporation, which means foreign corporation not engaged in trade or business in the Philippines, under Section 24(b)(1) of the Revenue Code, IWP is taxable only on income from sources within the Philippines. Clearly, therefore, IWP's agency commissions, which are income from sources without the Philippines, are not subject to Philippine income tax. And since under the provisions of Sections 53 and 54 of the Revenue Code, the legal and personal liability of petitioners to deduct and withhold from the agency commissions the income tax due thereon, file the requisite withholding tax return and pay the tax withheld to the Bureau of Internal Revenue is dependent on the derivation or realization of IWP of income from sources within the Philippines, petitioners' liability as withholding agents did not attached.

We do not share the view of respondent that the services of IWP for which it received agency commissions were performed in the Philippines because there is a decision of the Supreme Court of Hongkong in the case of the Commissioner of Inland Revenue vs. International Wood Products, Ltd.; in Inland Revenue Appeal No: 2 of 1971, stating that IWP is not subject to any tax for the reason that the services rendered by it were outside Hongkong. Nowhere in the Hongkong Supreme Court decision, relied upon by respondent, can we deduced, even only by implication, that the services rendered by IWP under its agency contracts with petitioners were performed in the Philippines. And the fact that the Supreme Court of Hongkong found that the services of IWP were rendered outside Hongkong does not logically follow that such services were performed in the Philippines. As stated above, all the acts and services of IWP which it bound itself to render for and on behalf of petitioners and for which it received agency commissions were performed in Korea, Japan and Taiwan.

Anent the question of whether or not the subsequent examination of the books of accounts and other accounting records of petitioners in 1972 by respondent, which gave rise to the present controversy, was barred by the prior 1971 investigation, Section 337 of the Tax Code provides that examination and inspection can be made only once in a taxable year during the five-year period that such books and records are required to be preserved, except in case of fraud, irregularity or mistake, or unless the taxpayer requests otherwise. Indeed, as stated by petitioners, the purpose of the law is to secure taxpayers against abuses arising from multiple or unreasonable investigations.

However, in ordering the investigation of petitioners, we notice that respondent acted on a confidential information filed with his Office sometime in February 1972 on their failure to withhold the tax on the commissions remitted to IMP for the years 1968 to 1970. Since, under the premises, the return required by law as basis for the assessment of the tax was not filed by petitioners and/or the tax due thereon paid (on the honest belief perhaps that they were not required to do so), or at least, respondent had reason to believe that there was fraud, irregularity or mistake, he should, before he can assess the proper tax on the best evidence obtainable under Section 15 of the Revenue Code, order an investigation. As Commissioner of Internal Revenue, respondent should endeavor to collect and insist on the collection of every centavo of internal revenue tax lawfully due the Government, but fairness also requires that before he issues an assessment, he should first investigate to make sure that no harrassment or injustice is done to taxpayers.

At any rate, we notice in the instant case that an investigation of taxable years 1968, 1969 and 1970 was made in 1971 by respondent, resulting in deficiency assessments that were duly paid by petitioners. It appears that respondent wrote petitioners closing and terminating these taxable years. While respondent authorized another investigation in 1972, which petitioners claim as not falling within any of the exceptions mentioned in Section 337 of the Tax Code, it will be noted that petitioners' books of accounts and other records were subjected to examination and inspection only once in a taxable year— in 1971 and in 1972. There was therefore no multiple examination and inspection of petitioners' books and records in a taxable year.

Accordingly, the decision of respondent Commissioner of Internal Revenue holding petitioners Paper Industries Corporation of the Philippines and Bislig Bay Lumber Co., Inc., liable for the amounts of ₱1,294,097.23 and ₱2,028,790.00, respectively, representing withholding tax for the years 1968, 1969 and 1970 because of their failure to withhold income tax from the agency commissions received by theif sales agent, the International Wood Products, Ltd., cannot be sustained.

WHEREFORE, the decision appealed from should be as it is hereby reversed. No costs.

SO ORDERED.

Quezon City, September 15, 1976.

AMANTE FILLER
Associate Judge

WE CONCUR:

ESTANISLAO R. ALVAREZ
Presiding Judge

CONSTANTE C. ROAQUIN
Associate Judge