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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

August 22, 1960

NORTON & HARRISON CO.,
Petitioner,

- versus - C.T.A. CASE NO. 254

COLLECTOR OF INTERNAL REVENUE,
Respondent.

x - - - - - - - - - - - x

D E C I S I O N

The respondent assessed against the petitioner the sum of ₱32,662.99 as deficiency sales tax and surcharge on sales of hollow blocks from July 1, 1949 to March 31, 1953, plus an additional "penalty" of ₱300.00. Upon failure of petitioner to secure a reconsideration of the assessment, the present appeal has been instituted to review the decision of respondent.

On June 22, 1956, before trial, petitioner filed a petition to enjoin respondent from enforcing the collection of the assessment by distraint and levy pending final determination of the case. On July 7, 1956, the petition was granted, subject to the filing by petitioner of a surety bond for ₱33,000.00. A surety bond for said amount was filed by petitioner, as principal, and the Philippine Surety & Insurance Co., Inc., as surety, which bond was duly approved by this Court. Subsequently, the said surety bond was substituted, with the approval of this Court, by another surety bond of the Filipinas Compañia de Seguros (F.C.S. No. 31968), which bond was later amended to include the sum of ₱300.00 as part of the liability of petitioner guaranteed by said bond.

As respondent raised the issue of the jurisdiction of this Court to take cognizance of the appeal, on the ground that the appeal was filed beyond the statutory period, a preliminary hearing was conducted upon a motion to dismiss filed by respondent. After hearing, this Court, in its Resolution of September 26, 1957, found that the appeal was filed within the thirty-day period prescribed in Section 11 of Republic Act No. 1125 and accordingly denied the motion to dismiss.

The case is now before us, after due trial on the merits, on the sole issue whether or not the assessment has been validly made against petitioner.

From the evidence of record, it appears that petitioner entered into an agreement on July 27, 1948, with Jackbilt Concrete Block Co., Inc. (hereinafter referred to as JACKBILT) wherein the former was appointed by the latter as sole and exclusive distributor of concrete blocks manufactured by it. For convenience, the said agreement is quoted below:

July 27, 1948

Norton & Harrison Co.
814 Echague Street
Manila

Attn: Mr. J. E. Norton,
Vice-President

Gentlemen:

As a consequence of our recent discussions, we wish to submit this letter as a proposal for your company to act as the exclusive distributor for Jackbilt Concrete

Blocks in the Republic of the Philippines. Should you accept the distributorship for our product, we would expect you company to conform to the following conditions:

1. Advertising expense shall be borne equally by the Jackbilt Concrete Block Co., Inc. and the Norton & Harrison Co.

2. Method of and budget for advertising shall be determined by mutual agreement. However, we expect that the public in general and specifically the contractors, architects, engineers, etc., shall be completely aware at all times of what we have to offer.

3. We shall submit to you a complete price list of all types and sizes of blocks. These prices will include delivery anywhere within the city limits of Manila. The prices shall be the prices to you and it is expected that you will market them at prices such that our products will be competitive at all times. Should there be any price changes, you will be notified in writing and these changes will take place thirty (30) days following the date of the letter.

4. Any business or sales that are totally a result of the efforts of this company, shall be directed thru our office. Norton & Harrison Co. will participate to the extent of five per cent (5%) of the gross sales. Further, this company will bear the entire responsibility as to credit, conditions, billing and collections for any such business.

5. Norton & Harrison Co. will provide all sales personnel requisite for complete coverage of the market.

6. This distributorship can be terminated at any time upon thirty (30) days written notice by either company.

If you desire the agency for marketing our products under the above stated conditions, please signify by signing for your company in the space provided in the lower left hand corner of this page. In closing we hope that the above proposal meets your approval. We remain

Yours very truly:

JACKBILT CONCRETE
BLOCK CO., INC.

By:

J. E. MORTON
Vice-President
Morton & Harrison Co.

JACK A. RUSSEL
President

Under the aforesaid agreement, when an order for concrete blocks was received by petitioner from a customer, the order was transmitted to JACKBILT which delivered the concrete blocks direct to the customer. The customer paid to petitioner the selling price of the concrete blocks. In turn, petitioner paid to JACKBILT the amount charged to the customer less a certain amount as its compensation or profit. For example, in the case of the sale of 420 pieces of concrete blocks to the American Builders on April 1, 1952, the purchaser paid to petitioner the sum of ₱189.00 as the purchase price, but petitioner paid to JACKBILT the sum of ₱168.00. (See Exh. 15-C, page 20, BIR records.) JACKBILT treated the transaction as one involving a sale by it of the concrete blocks to petitioner which in turn sold the blocks to the American Builders, so that the original sale which is taxable is the supposed sale to petitioner and not the sale to the latter's customer. It was under these circumstances that sales of concrete blocks manufactured by JACKBILT were made from July 27, 1948 to May 1, 1953, on which latter date, the distributorship or agency agreement was terminated and a management agreement was entered into between the parties (petitioner and JACKBILT), whereby petitioner undertook to sell concrete blocks for JACKBILT for a fixed management fee of ₱2,000.00 per month, which was later increased to ₱5,000.00 per month.

On June 10, 1949, during the existence of the distributorship or agency agreement, petitioner acquired the outstanding shares of stock of JACKBILT, making the latter a corporation owned and controlled by the former. Because of this acquisition by petitioner of the outstanding shares of stock of JACKBILT, respondent assessed against petitioner the sum of ₱32,662.99 as deficiency sales tax and surcharge on the basis of the sales of JACKBILT blocks to the public for the period from July 1, 1949 to March 31, 1953. Respondent contends that since JACKBILT was owned or controlled by petitioner, the corporate personality of the former may be disregarded for sales tax purposes and the sales of JACKBILT blocks by petitioner to the public were the original sales subject to the sales tax. Respondent apparently concedes that the transactions between the parties under the distributorship or agency agreement were in the nature of sales of concrete blocks by JACKBILT to petitoner which in turn sold the blocks to the public.

The law applicable to the case is Section 186 of the National Internal Revenue Code which imposes a percentage tax of 7%[1] 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 of 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 purchasers directly. There was no instance in which the blocks ordered by the purchasers were delivered to 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

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1 Effective Sept. 22, 1950, pursuant to Rep. Act No. 588.

as agent of JACKBILT. The distributorship agreement of July 27, 1948, is denominated by the parties themselves as an "agency for marketing" JACKBILT products. We quote from the last paragraph of said agreement:

> "If you desire the agency for marketing our products under the above stated conditions, please signify by signing for your company in the space provided in the lower left hand corner of this page." (Emphasis supplied.)

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 as the manufacturer and not against petitioner which merely acted as the former's agent.

In assessing the deficiency sales tax in question against petitioner, respondent claims that since JACKBILT was owned or controlled by petitioner, the alleged sales by the former to the latter were not at arm's length. Accordingly, the corporate personality of JACKBILT may be disregarded and the sales to the public of concrete blocks are to be treated as the original sales. As stated above, there is no necessity for respondent to have disregarded the corporate personality of JACKBILT in order to reach by taxation the sales of JACKBILT blocks to the public. But even granting the correctness of respondent's theory that sales of concrete blocks were made by JACKBILT to petitioner under the distributorship agreement of July

27, 1948, the position taken by him is untenable.

Our law imposing sales tax on original sales of goods wares or merchandise by manufacturers, producers or importers are patterned after the corresponding excise tax provisions of the United States Internal Revenue Code. The prevailing view in the United States is that sales transactions between affiliated or related corporations are recognized as valid if they are made bona fide and at arm's length. The corporate existence or personality of a corporation may not be disregarded simply because it sells or buys goods from an affiliated corporation. (See Campana Corp. v. Harrison, 135 F. (2) 334, 30 AFTR 1443; Standard Oil Co. v. U. S., 63 F. Supp. 48, 34 AFTR 682, cited in PH Federal Taxes [1955], Par. 38421.) The Bureau of Internal Revenue of the United States expressed a similar opinion, thus:

> "X manufactured and sold its products to Y Retail Corporation, which owned all X stock. Through its ownership of this stock, Y fixed prices at which the articles were sold to it by X. Held, under the 1921 Act, the actual manufacturer, the X Corporation, was liable for the tax computed upon the basis of the price at which the articles were sold by it, unless it could be shown that X sold articles at less than the fair market price obtainable therefor so as to directly or indirectly benefit the Y Corporation." (S.T. 366, C.B. June, 1922, p. 439, cited in PH Federal Taxes [1955], Par. 38,421.)

In this case, the distributorship agreement between petitioner and JACKBILT was entered into by the parties on July 27, 1948. This agreement was in force up to May 1, 1953. The controlling stock of

JACKBILT was acquired by petitioner on June 10, 1949, and the assessment of the deficiency sales tax against petitioner covers the period from July 1, 1949 to March 31, 1953, during the existence of the distributorship agreement of July 27, 1948. It is admitted that the transactions between the parties, before and after the acquisition by petitioner of the majority stock of JACKBILT, were made strictly in accordance with said agreement. Respondent also concedes that the transactions between the parties before the acquisition of the controlling stock of JACKBILT by petitioner were _bona fide_ and at arm's length. To quote from the report of B.I.R. Agent A. M. Gualberto:

> "As stated earlier in this report, the product of Jackbilt was, and is still being sold exclusively to Morton & Harrison Company, the latter acting as exclusive distributor. As long as the two corporations existed independently of each other, there is nothing wrong with this arrangement for Morton & Harrison has long been dealing in construction materials." (See pages 23-25, B.I.R. records.)

In other words, while admitting that the transactions between the parties were _bona fide_ and at arm's length before the acquisition by petitioner of the controlling stock of JACKBILT, it is the view of respondent that the transactions between the parties under the same conditions and circumstances became a sham and not at arm's length simply because the parties became affiliated corporations. We have been unable to find authority to support this view. The cases cited by respondent are absolutely not in point.

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.

SO ORDERED.

Manila, August 22, 1960.

R M Umali
ROMAN M. UMALI
Associate Judge

I CONCUR:

Augusto M. Luciano
AUGUSTO M. LUCIANO
Associate Judge

Presiding Judge MARIANO NABLE dissents in a separate opinion.

NORTON & HARRISON CO.,
Petitioner,

- versus - C.T.A. CASE NO. 254

COLLECTOR OF INTERNAL
REVENUE,
Respondent.

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DISSENTING OPINION

I believe that the assessment appealed from should be modified.

The fact of ownership, alone, by one corporation of the capital stock in another does not breed an identity of corporate interest between the two companies, or create a relationship of principal and agent between the two. (Pullman's Palace Car. Co., vs. Missouri P.R. Co., 115 U.S. 587, 29 L. ed. 499, 6 Sup. Ct. Rep. 194, Peterson v. Chicago, R.I. & P.R. Co. 205 U.S. 364, 391, 51 L. ed. 841, 852, 27 Sup. Ct. Rep. 513; U.S. ex rel. Atty. Gen. v. Delaware & H. Co. 213 U.S. 366, 413, 53 L. ed. 836, 951, 29 Sup. Ct. Rep. 527; Interstate Commerce Commission v. Stickney, 215 U.S. 98, 108, 54 L. ed. 112, 114, 30 Sup. Ct. Rep. 66; U.S. v. Delaware, L. & W. R. Co. 238 U.S. 516, 529, 530, 59 L. ed. 1438, 1443, 1444, 35 Sup. Ct. Rep. 873.) This jurisprudential conclusion has been repeatedly held not applicable to cases where stock ownership has been resorted to, not for the purpose of participating in the affairs of a corporation in the normal and usual manner, but for the purpose of controlling a subsidiary company so that it may be used as a mere agency or instrumentality of the owning company. (U.S. v. Lehigh Valley R. Co. 220 U.S. 257, 273, 55 L. ed. 458, 463, 31 Sup. Ct. Rep. 387; U.S. v. Delaware, L.& Co. R. Co., supra.) In this latter instance, the courts, disregarding the fiction of separate corporate forms, will regard only the substance of the transaction involved as if the corporate agency did not exist (Chicago, M.& St. P. R. Co. v. Minneapolis C. & C. Asso., 247 U.S. 490, 501, 62 L. ed. 1229, 1237) and treat the one who actually may take the benefit of the income as the owner of the property which produces it and tax him accordingly (Paymer v. Commissioner, 150 F 2d 334, citing Higgins v. Smith, 308 U.S. 473, 60 S. Ct. 355, 84 L. ed. 406).

In the case at bar, there are certain circumstances that compel me to the opinion that the ownership by Norton & Harrison Co. of the outstanding shares of stock of Jackbilt Concrete Block Co., Inc. was resorted to to enable the former not only to participate in the affairs of the latter in the normal and usual manner, but to control and direct the latter as its mere agency or instrumentality. Some of these circumstances are: the reorganization, on July 15, 1949 of the Board of Directors of Jackbilt by the constitution of a new one composed of five members, four of whom were either officials or employees of Norton (Exhibits V-1 & 15, p. 25, BIR rec.; see also Exhibits

K & 41); the fact that the president and treasurer of Norton was also holding similar positions in Jackbilt (Exhibits D-1, O, 19-E & 20-H); the making of advances by Norton for payments of various expenses incurred by Jackbilt (Exhibits 12, 14, 14-A to 14-F, 33 to 39); the obtaining of a loan from the Rehabilitation Finance Corporation amounting to ₱250,000.00 by Norton and the mortgaging therefor of the properties of Norton and Jackbilt (p. 221, t.s.n.); the imposing manner with which Norton fixed its monthly management fees (see Exhibits N and P) and Jackbilts submissive mien in agreeing thereto (see Exhibit O); the maintenance of gasoline facilities common to Norton and Jackbilt (pp. 882-883, t.s.n.); the availability for use by Jackbilt's employees of the Baguio house and lot, which were registered in the name of Norton and the payment by Norton and Jackbilt of expenses incurred in connection therewith on a 50-50 basis.

Upon the afore-stated 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.

Finding the instant assessment for sales tax to be in accordance with law and that the same has not been seasonably paid, the 25% surcharge sought to be imposed is in order. However, as regards the imposition of ₱300.00 as extrajudicial settlement, it is well settled that petitioner cannot be compelled to pay said amount, there being no agreement between the parties regarding payment thereof (Collector of Internal Revenue v. U.S.T., G.R. No. L-11274 & L-11280, November 28, 1958; Collector of Internal Revenue v. Bautista and Tan, G.R. No. L-12250 & L-11259, May 27, 1959). The filing of a bond to secure the payment, among others, of administrative penalty in extrajudicial settlement of penal liability that may be adjudged in favor of the Republic of the Philippines cannot be considered as a mutual agreement for payment therefor because the said filing was effected merely in compliance with the condition precedent to the lifting of the warrant of distraint and levy.

My vote, therefore, is to modify the assessment appealed from in the sense that petitioner Norton & Harrison Co. should pay respondent Collector (now Commissioner) of Internal Revenue the sum of ₱32,662.99, as deficiency sales tax and 25% surcharge thereon.

MARIANO NABLE
Presiding Judge