YUTIVO SONS HARDWARE COMPANY,
Petitioner,

versus

C.T.A. CASES NOS. 673, 675 and 870

COMMISSIONER OF INTERNAL REVENUE,
Respondent.
x- - - - - - - - - - - -x

D E C I S I O N

In these three cases, which were consolidated because they involve the same parties and the same issues, petitioner Yutivo Sons Hardware Company seeks the review of three separate assessments of respondent Commissioner of Internal Revenue for deficiency income taxes. The deficiency assessments arose from the consolidation of the net taxable incomes of Yutivo Sons Hardware Company (hereinafter referred to as "Yutivo") and the Southern Motors, Inc., during the years 1951 to 1954, 1957 to 1958 and 1959.

The parties are in agreement that the assessments involved are based on the ruling of this Court in C.T.A. Case No. 64, "Yutivo Sons Hardware Company vs. Collector of Internal Revenue," April 27, 1957, that "Southern Motors was but a mere instrumentality, adjunct, subsidiary, branch, alter ego or hechura of Yutivo." As consequence of this decision, respondent ruled that the income of Southern Motors should be consolidated with the income of petitioner. From 1951

243

when the graduated corporate income tax under Republic Act No. 600 took effect, the consolidation of the incomes of both would thereby bring about a deficiency of 8% represented by the difference between the 20% actually paid by the Southern Motors on the first ₱100,000.00 of its net income and the 28% on the same amount which Yutivo should pay under and by virtue of the judgment of this Court. The parties are also in agreement as to the correctness of the computations of the taxes paid by petitioner and Southern Motors during the periods under consideration, as well as the amount to be paid by Yutivo in the event that these cases are decided in favor of respondent.

The collision occurs in respect of the application of the holding of the Supreme Court in G.R. No. L-13203, "Yutivo Sons Hardware Company vs. Court of Tax Appeals and Collector of Internal Revenue," January 28, 1961, which is the appeal from C.T.A. Case No. 64 of this Court, wherein it was held that "Southern Motors being but a mere instrumentality or adjunct of Yutivo, the Court of Tax Appeals correctly disregarded the technical defense of separate corporate entity in order to arrive at the true tax liability of Yutivo" (p. 20, Decision). Petitioner insists that this conclusion of the Supreme Court should be limited to its sales tax liability, the tax involved in that case;

245

while respondent counters that it should apply to all matters involving taxes, including the income tax on the incomes of both Yutivo and its sister corporation.

At this juncture, it should be stated that because of the identity of the parties and the close similarity of the issues involved, these cases should be read in the light of the decision of the Supreme Court in G.R. No. L-13203. As a matter of fact, it might even be added that, for purposes of determining the taxability of Yutivo in its relation to Southern Motors, they are merely the continuation of case G.R. No. L-13203, with the instant cases involving the question of Yutivo's income tax liability and the latter case deciding its sales tax liability. As a basis for the discussion of the question as to whether or not Southern Motors is a mere instrumentality or branch of Yutivo for purposes of these cases, the facts and legal principles involved in G.R. No. L-13203 are therefore pertinent.

In support of its thesis, much stress is placed by petitioner on the statement of the Supreme Court that this Court "was not justified in finding that Southern Motors was organized for no other purpose than to defraud the Government of its lawful revenues."

246

Since the Supreme Court found that Southern Motors was not organized purposely as a tax evasion device, petitioner now contends that the premises supporting this Court's corporate disregard of Southern Motors' separate personality were expressly rejected by that Court. Inferentially, petitioner states that Southern Motors, having been found by the Supreme Court to have been organized in good faith and for legitimate purposes, it is entitled to declare as its own the income it actually derived from its own business and to file an income tax return separate from that of petitioner. And averring that the assessments in question are based upon the findings of this Court which were allegedly rejected by the Supreme Court, petitioner concludes that there is no basis for disregarding Southern Motors' separate juridical personality.

We are at a loss to see how petitioner deduced from the decision of the Supreme Court the conclusion that the identify and merger of Yutivo and Southern Motors should be limited only to the sales tax. In the first place, nowhere in the decision did the Supreme Court imply that it is only applicable to petitioner's sales tax liability. Whatever the dialectics employed, the Supreme Court held that Southern Motors being a mere instrumentality or adjunct of Yutivo, the separate corporate entity of Southern Motors should be disregarded to arrive at the true tax liability of Yutivo.

By its decision, the Supreme Court looked beyond the corporate form of Southern Motors and ignored completely its separate jural existence. In law and in fact, and for all practical purposes, Yutivo and Southern Motors are merged, the latter being but a part of the former, acting merely as its department and subject in all things to its proper direction and control for the purpose of its business. Thus the Supreme Court held:

> "We are, however, inclined to agree with the court below that SM (Southern Motors) was actually owned and controlled by petitioner (Yutivo) as to make it a mere subsidiary or branch of the latter created for the purpose of selling the vehicles at retail and maintaining stores for spare parts as well as service repair shops." (P. 13, Decision.)

This situation is not materially different from the not infrequent business practice of a manufacturing plant opening several departments or branches in different localities or places for the purpose of selling its products and maintaining stores and shops for spare parts and repair service. If the sale of the branch is the sale of the manufacturing plant, it must necessarily follow that the income of the former is the income of the latter.

As stated above, much emphasis is placed by petitioner upon the statement of the Supreme Court that Southern Motors was not organized purposely as a tax evasion device. But granting that what the Supreme Court had in mind in making this finding was that Southern Motors was organized for a legitimate purpose, or even a business purpose which petitioner wants us to understand, a perusal of the entire decision in G.R. No. L-13203 will readily show that, in ignoring the separate jural existence of Southern Motors, the Court considered as significant the domination and control, because of common ownership, exercised by Yutivo over the former. As a matter of fact, the close relationship between Yutivo and Southern Motors because of common ownership, and the management and control of operations, cash transactions, policies and day-to-day activities dependent thereto, was the basis for the conclusion reached, whatever its articulation. We see no importance in the allegation of petitioner that Southern Motors was organized for a legitimate purpose except for determining the imposition of the fraud penalty, which was precisely the purpose of the Supreme Court in ruling out the 50% surcharge imposed by this Court. (See p. 11, Decision.)

Petitioner however argues that the circumstances prior to 1950, which were the bases of the decision of the Supreme Court in G.R. No. L-13203, had ceased to

249

exist after that year and the relationship between Southern Motors and Yutivo thereafter had been considerably altered. Thus, petitioner alleges that it ceased to be a stockholder in Southern Motors after 1950; that not all stockholders of petitioner are stockholders of Southern Motors and vice-versa; that the branches of Southern Motors had their set of operating officers separate and distinct from Yutivo; that Southern Motors opened its own bank accounts separate from petitioner; that Southern Motors had its own assets and property distinct from those of Yutivo; that Southern Motors had business transactions also involving motor vehicles with entities which were engaged in business in competition with that of petitioner; that Southern Motors filed claims against Yutivo arising from defects in cars and trucks sold by petitioner to it. In short, petitioner avers that the indicia of control and identify on which the Supreme Court based its conclusion in the sales tax case (G.R. No. L-13203) that Southern Motors was an instrumentality or adjunct of Yutivo were weeded out to show beyond reasonable doubt the separate corporate existence and personality of Southern Motors. (Pp. 11-12, Petitioner's Reply Memorandum.)

So far as common ownership, control and management are concerned - the essential ingredients of case G.R. No. L-13203 - we can see that they are still the important and significant components of these cases. A closer scrutiny of the evidence presented, both testimonial and documentary, reveals that petitioner continues to have control and management over Southern Motors (p. 94, t.s.n.). The controlling members of the Board of Directors of petitioner and those of Southern Motors continued to be in the same hands, namely: Yu Khe Thai, Yu Khe Siong, Yu Khe Jin, Yu Eng Pho, Dalton Chen, Yu Khe To and Yu Cheng Kho (Exhs. K, p. 122; L, p. 47); and these directors named, who are brothers, sisters, cousins or close relatives belonging mostly to the Young or Yu family, are the controlling stockholders of petitioner and Southern Motors (Exh. K, pp. 122, 128; Exh. H-1). The presidency of Yutivo and Southern Motors remained with Yu Khe Thai (p. 101, t.s.n.). While Southern Motors maintained separate bank accounts, the ones authorized to withdraw from these funds were Simeon Sy, Yu Khe Jin, Yu Khe Siong and Yu Khe Thai (pp. 31-34, t.s.n.) who were the officers and/or members of the Boards of Directors of both petitioner and Southern Motors.

It should be noted that Yu Khe Thai, Yu Khe Siong, Yu Khe Jin and Yu Khe To, controlling members

757

of the Boards of Directors of both Yutivo and Southern Motors, are brothers. Yu Eng Pho, another member of the Boards of Directors of both petitioner and Southern Motors, is the first cousin of Yu Khe Thai, Yu Khe Siong and Yu Khe Jin. Yu Cheng Pho, manager of the Cebu branch of petitioner, is the second cousin of Yu Khe Thai, Yu Khe Siong and Yu Khe Jin. (Exh. L, p. 46; Exh. 1, pp. 6-7.) Yu Cheng Kho, another director of both Yutivo and Southern Motors, is the second cousin of Yu Khe Thai, Yu Khe Siong, Yu Khe Jin and Yu Khe To. (Exh. 1, p. 47; Exh. 1, pp. 6-7.) Simeon Sy, who was formerly the common comptroller of petitioner and Southern Motors during the years 1946 to 1950, continued to be the treasurer of Southern Motors (Exh. K, p. 128) but at the same time the assistant to the president of Yutivo - Yu Khe Thai (Exh. L, p. 57). Those who owned substantial number of stocks of Southern Motors were Francis Yu, Simeon Sy, C. J. Huang and Yu Khe Tat. (Exh. K, p. 125.) Francis Yu is the son of Yu Khe Thai; Simeon Sy is a brother-in-law of either Yu Khe Thai or Yu Khe Jin (Exh. 2, p. 6 and Exh. K, p. 144); and C. J. Huang, manager of the Cebu branch of Southern Motors, is the brother-in-law of Yu Khe Thai, president of both petitioner and Southern Motors (Exh. L, p. 144).

252

All these merely serve to corroborate the fact that there was a common ownership and interest in the two corporations. While it may be true, as claimed, that petitioner did not in its own name hold stocks in Southern Motors, the ownership by the Yu or Young family, including their close relations, of most of the stocks of both corporations, and the control primarily dependent upon such ownership, placed them in a position where the policies and daily activities of petitioner and Southern Motors were determined not as decisions of the corporations acting separately but by the Yu family acting collectively. There is, therefore, no doubt that by virtue of such ownership and control, the business, financial and management policies of both corporations could be and in fact were directed towards common ends. (See p. 16, Decision, G.R. No. L-13203.) Consequently, we see no significance in the allegations of petitioner that it had never been a stockholder of Southern Motors; that since 1951, 36.5% of its stockholders do not own stocks in Southern Motors and, similarly, 19% of the stockholders of the latter did not own stocks in the former; and that the stockholders of Southern Motors have sold, pledged or otherwise disposed of their shares.

253

Likewise, the fact that Southern Motors is engaged in the substantial business of retailing new and used cars and trucks, spare parts and accessories, and operates car and truck repair shops and gasoline stations; that it purchased new cars and trucks for retail not only from petitioner but also from Liddell & Co., the Rizal Motors, Inc., and the Northern Motors, Inc.; that Southern Motors operates branches in Cebu, Davao and Bacolod is of no consequence because such arrangements are required by its business of assembling and selling vehicles and maintaining stores for spare parts and repair service. To be able to cater to the whims and caprices of the buying public, petitioner must have for sale not only the vehicles that it manufactures or imports but also other makes and brands, new or used, to accommodate the differences in tastes, likes and pocket books of everybody, specially for trade-in purposes.

Nor the allegations that Southern Motors paid its taxes; had its own employees; maintained separate deposits for its funds; kept its own books of accounts; and filed its income tax returns have any significance in altering petitioner's identify with Southern Motors because these are merely formal, anticipatory designs to cover up the true relation between both corporations. Common ownership of petitioner and Southern Motors by the YU or Young family, and the control and domination incident thereto, can have no different tax consequences merely by the separateness of books, employees, tax returns or payment of taxes. The separateness of the corporate entity of Southern Motors was disregarded by the Supreme Court on account of the fact that, essentially, common ownership of the stock was used to control and dominate it, and since this is still the basic substance of these cases, we can see no cogent and compelling reason to modify the Court's decision.

In the light of the above, we are of the opinion and so hold that, notwithstanding the allegations of petitioner that the facts prior to 1950, which were the bases of the decision of the Supreme Court in case G.R. No. L-13203 had ceased to exist after that year and the relationship between Yutivo and Southern Motors had already been altered, Southern Motors is still a mere instrumentality or branch of Yutivo so that its separate corporate entity should be disregarded to arrive at the true tax liability of petitioner even for purposes of income taxation.

Assuming, arguendo, that Yutivo and Southern Motors are controlled by substantially the same interests, petitioner however argues that that circumstance by itself and without evidence of artificial shifting of

355

income or expenses from one to the other does not confer authority upon respondent to attribute to Yutivo the net income earned by Southern Motors. According to petitioner, the Tax Code contains no provision authorizing respondent to require or permit two or more corporations, even if controlled by the same interests, to file a consolidated return of their separate incomes. On the contrary, Section 24(a) of the same Code explicitly recognizes the separate taxability of "every corporation organized in, or existing under the laws of, the Philippines, no matter how created or organized." It is therefore urged that instead of vesting respondent authority to consolidate the separate incomes of these corporations, the law merely authorizes him "to distribute, apportion, or allocate gross income or deductions" among them under the provisions of Section 44 of the Revenue Code. And such a limited authority may be exercised only when it is shown that a "distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income" of the controlling and the controlled corporations.

The relationship between petitioner and Southern Motors is a continuing one because the umbilical cord connecting them remains intact and uncut. As stated

252

above and ruled by the Supreme Court in case G.R. No. L-13203, Southern Motors is merely a subsidiary or branch of Yutivo created for the purpose of selling the vehicles it assembles at retail and maintaining stores for spare parts as well as service repair shops; and being merely an instrumentality or adjunct of petitioner, its separate corporate entity should be disregarded in order to arrive at the true tax liability of Yutivo. If Southern Motors is but a part of Yutivo, acting merely as its department or branch in selling vehicles at retail and maintaining stores for spare parts as well as service repair shops, without any separate jural existence, the income of Southern Motors must necessarily be the income of Yutivo. The income of Southern Motors is no less taxable income in the hands of Yutivo merely because by its command and direction it is paid directly to Southern Motors in the performance of its duty as a mere subsidiary or branch of Yutivo; otherwise, the reach of the income tax law can be delimited by technical refinements or mere formalism. (Helvering v. Clifford, 309 U.S. 331.) Since income should be taxed to those who earn it, despite anticipatory agreements designed to prevent vesting of the income in the earners (Lucas v. Earl, 281 U.S. 111; Helvering v. Clifford, 309 U.S. 331; United States v. Joliet & Chicago R. Co., 315

U.S. 44; Commissioner v. Sunnen, 333 U.S. 591), respondent is correct in attributing to petitioner the net income earned by Southern Motors.

The fallacy of petitioner's position is its assumption that Southern Motors, for purposes of determining the taxability of Yutivo, is still a corporation distinct and separate from petitioner. Herein lies the inapplicability of Section 44 of the Revenue Code. Petitioner and Southern Motors are not two "organizations, trades, or business x x x owned and controlled directly or indirectly by the same interests" under the provisions of Section 44; they are one and the same taxable person, for purposes of taxation.

Anent the question as to whether or not respondent can validly assess the fraud penalty of 50%, we agree with petitioner that this is already foreclosed by the decision of the Supreme Court in G.R. No. L-13203. In eliminating the 50% fraud penalty imposed by this Court in that case, the Supreme Court stated that Southern Motors was not organized purposely as a tax evasion device to defraud the Government of its revenues. The Court ruled that resort to tax saving devices without the use of pretenses and forbidden devices to lessen or defeat taxes does not constitute fraud. (See also Liddell v. Coll. G.R. No. L-9687,

258

June 30, 1961.) And it can hardly be said that there was a consistent underdeclaration of substantial income by petitioner in not reporting as its own the net income earned by Southern Motors during the periods covered by these cases (1951 to 1954, 1957 to 1958 and 1959) because in G.R. No. L-13203, which finally determined the true tax status of Yutivo in relation to Southern Motors, was decided only on January 28, 1961, which was after 1959. Even then, there was still a difference of opinion as to whether the conclusion reached by the Supreme Court in that case applies also to the income tax liability of petitioner.

With this finding that there is no element of fraud present in petitioner's failure to include the net income earned by Southern Motors in its income tax returns, the right of respondent to assess the deficiency income tax for 1951 has already prescribed. There is no evidence as to when petitioner filed its 1951 income tax return but it is not disputed that both Yutivo and Southern Motors filed separate income tax returns for their respective incomes in that year within the period provided for by law. Since the deficiency income tax assessment for 1951 was issued by respondent only on December 17, 1957 or more than five (5) years after petitioner's income tax return was filed, the right of respondent to assess deficiency income tax for 1951 has already prescribed under Section 331 of the Tax Code.

Having found that the deficiency assessment for the year 1951 has already prescribed, and after eliminating the 50% surcharge imposed by respondent from his other deficiency assessments, petitioner Yutivo Sons Hardware Company is hereby held liable and ordered to pay the Commissioner of Internal Revenue:

(a) From 1952 to 1954, inclusive, the total amount of ₱24,000.00, plus 5% surcharge and 1% monthly interest from January 16, 1958 up to the date of payment but not exceeding 36%, under C.T.A. Case No. 673;

(b) For 1957 and 1958, the total amount of ₱16,000.00, plus 5% surcharge and 1% monthly interest from July 11, 1959 up to the date of payment but not exceeding 36%, under C.T.A. Case No. 675; and

(c) For 1959, the amount of ₱8,109.26, inclusive of 1/2% monthly interest on ₱8,000.00 from April 19, 1960 to July 11, 1960, plus the delinquency penalties incident to late payment under Section 51(e) of tne National Internal Revenue Code, as amended by Republic Act No. 2343, under C.T.A. Case No. 870.

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WHEREFORE, with the foregoing modifications, the appealed decisions are hereby affirmed, without pronouncement as to costs.

SO ORDERED.

Quezon City, September 30, 1968.

ROMAN M. UMALI
Presiding Judge

WE CONCUR:

ESTANISLAO R. ALVAREZ
Associate Judge

RAMON L. AVANCEÑA
Associate Judge

261