REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

LIDO EXPORT, INC.,
Petitioner,

- versus -

C.T.A. NO. 4879

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
APR 24 1995

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DECISION

This is an assessment case amounting to a total of P3,016,788.23 representing alleged deficiency withholding taxes for taxable year 1987.

Petitioner, a corporation organized and existing under the laws of the Republic of the Philippines, is engaged in the manufacture and export of table linens and other tabletop accessories.

On June 7, 1990, Petitioner received from Respondent a demand letter accompanied by assessment notice numbers FAS-1-87-90-002278, FAS-1-87-90-002279, and FAS-1-87-90-002280, demanding the payment of "P3,016,788.23 representing deficiency withholding taxes, including increments thereon, details of which are shown hereunder:

Deficiency Final Withholding Tax
(Non-Resident Stockholders)
January to June, 1987

Accrued Amount per Audited Financial Statement ($250,000)		P5,112,500.00
Withholding tax due thereon (30%)	....	P1,533,750.00
LESS: Amount withheld	....	-
Deficiency Withholding Tax	....	P1,533,750.00
ADD: 25% surcharge	....	383,437.50
20% int. fr. 07-21-87 to 05-11-90	....	1,075,446.32
Compromise	....	15,000.00
TOTAL AMOUNT DUE AND COLLECTIBLE	....	P3,007,633.82

Deficiency Final Withholdoing Tax
(Cash Dividends)
January to June, 1987

Amount subject to tax	....	P 14,432.76
Withholding tax due thereon (10%)	....	P 1,443.27
LESS: Amount paid	....	-
Deficiency Withholding Tax	....	P 1,443.27
ADD: 25% surcharge	....	358.32
20% int. fr. 07-21-87 to 05-11-90	....	1,010.60
Compromise	....	100.00
TOTAL AMOUNT DUE AND COLLECTIBLE	....	P 2,742.59

Deficiency Expanded Withholding Tax
January to June, 1987

Withholding taxes due (various)	....	P 11,247.76
LESS: Payment per return	....	8,099.81
Deficiency expanded withholding tax	....	P 3,147.95
ADD: 25% surcharge	....	786.98
20% int. fr. 07-21-87 to 05-11-90	....	2,207.29
Compromise	....	100.00
TOTAL AMOUNT DUE AND COLLECTIBLE	....	P 6,242.22

(Exh. 4, BIR Record p. 237)

From the records of the Respondent, "it appears that herein taxpayer stands assessed and required to pay various deficiency taxes namely:

> 1. Deficiency final withholding tax on income payments paid to non-resident aliens not doing business in the Philippines in the amount of P3,007,633.82 with increments;
>
> 2. Deficiency final withholding tax on dividend payments to former stockholders in the amount of P2,912.19, likewise with increments, and
>
> 3. Deficiency expanded withholding tax on compensation in the amount of P6,242.22 (settled by actual payment)."
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> (Memorandum Report, BIR Records p. 75)

"As early as November 21, 1987, Petitioner paid the deficiency expanded withholding tax assessment (BIR P.O. No. 6537793 and CB C.R. No. 18451366) leaving the first two assessments as subject matter of Petitioner's protest which was filed with the Respondent on June 29, 1990." (Letter of Protest, BIR Records, p. 256).

In the said protest letter, Petitioner argued that the above assessments "have no factual and legal bases to stand on" since "the accrual of the liability to the former major stockholders of our company for their agreements not (to) compete in the linen business in the U.S. and other parts of the world is income from sources outside the Philippines and, therefore, not subject to the Philippine withholding tax" (ibid.). "x x x Moreover, the obligation to withhold arises only at the time of payment, not at the time of accrual. As of the fiscal year ended June 30, 1987, the payment for the agreement not to compete was not yet made as it is payable not earlier than March 31, 1988". (ibid).

With regard to deficiency final withholding tax of P2,912.19, Petitioner averred that "this item actually represents interest payments made by the company to its former stockholders. These advances were covered by promissory notes which provide for interest payments at competitive rates and with definite maturity period. We submit the fact that the interest was paid to a former stockholders does not mean that it is cash dividend. It is possible for a stockholder to make a valid loan and the interest is treated as such." (ibid.)

The Respondent, however, alleged that the introduction by the Petitioner of "a 'rescission document' where suddenly a sister company assumed and paid the liability - thus claiming it to be an income from outside the Philippines" (Memorandum Report, BIR Records, p. 275) "...was however considered by the undersigned revenue officers as a sham, fictitious and of no legal status whatsoever. It has been considered as a ploy, an unreasonable scheme to waylay the Philippine Government of the right to collect a valid tax. As it was aptly said in a case, "where the corporate form or organization is adopted or a corporate entity is asserted in an endeavor to evade a statute or to modify its intent, courts will disregard the corporation or its entity. This has been applied to violations of tax laws" (Fletcher, 170-171, Commentaries & Jurisprudence on the Commercial Laws of the Philippines by Agbayani, Vol. III, 1970 ed. p. 121). It was further held, that "where a corporation is a dummy, so unreal or a sham and serves no business purposes and is intended only as blind, like the sister company cited by the herein taxpayer which identity was not made known, the corporate form maybe ignored for the law cannot countenance a form that is bald and a mischievous fiction." (Leddel and Co. vs. Commissioner of Internal Revenue, L-9687, June 30, 1961, cited under RAMO No. 1-86)" (ibid p. 274)

Moreover, the above Revenue Examiners averred that:

> "It is a well settled regulation on withholding of tax that three requisites must concur in order that withholding shall take place, and these are:
>
> 1. the income must be fixed or determinable annual or periodical;
>
> 2. the income must be from sources within the Philippines; and

3. the income must be paid to non-resident alien individual not engaged in trade or business in the Philippines and not having an office or place of business therein. (**R.P. vs. Jose Razon and Jai-alai Corp.**; CTA Case No. #15566, Jan. 23-57)

All these requisites are indeed present in the instant case, and for that matter, Lido Export Inc. is well confirmed as a withholding agent herein. Corollarily, it was held in a case, that "withholding agent is constituted as the agent of both the government and the taxpayer. With respect to the collection and/or withholding of the tax, he is the Government agent. In regard to the filing of the necessary income tax return and the payment of the tax to the Government, he is the agent of the taxpayer. The withholding agent, therefore, is no ordinary Government agent especially because under Section 53 (c) he is held personally liable for the tax he is duty bound to withhold, whereas, the Commissioner of Internal Revenue and his deputies are not made liable by law." (**Phil. Guaranty Co. vs. Commissioner of Internal Revenue**, 13 SCRA, 775, NIRC by Jose Arañas, p. 247).
(Memorandum Report, BIR Records p. 274-273)

Thus, on November 10, 1992, Petitioner received a letter from the Respondent finally denying its protest. (Exh. 5, BIR Records, p. 293).

Hence, this appeal.

The issues presented in this case are the following:

1. Whether or not Petitioner is liable to withhold the 30% tax of the amount of $250,000.00 made payable to the Cromwells by reason of and pursuant to the non-competition agreement entered into between the latter and the Petitioner; and

2. Whether or not Petitioner is liable to pay deficiency final withholding tax on dividend payments.

We answer the first issue in the affirmative.

Petitioner, in its Memorandum insisted that it is not liable to withhold the tax "since no payment was actually effected and the Cromwells did not receive any income" (CTA Records, p. 229) and "that the $250,000.00 was actually paid by W/C Imports Inc. and the Petitioner never reimbursed the former..."(ibid., p. 230). "The Cromwells never received or realized income from Petitioner because the Non-competition Agreements were rescinded"(ibid., p. 229). This line of argument (that the Non-competition agreements were rescinded) as noted by this Court, was never used by the Petitioner in its protest letter in the administrative level. (see Protest Letter, BIR Records, p. 256) In fact, the BIR examiners were surprised when the Petitioner "introduced a 'rescission document' where suddenly a sister company assumed and paid the liability - thus claiming it to be an income outside the Philippines" (Underscoring supplied; BIR Records, p. 274). Deliberately or not, never in the Petition for Review or in the Memorandum did the Petitioner mention that W.C. Imports, Inc., is its sister company. It was only during the presentation of the Petitioner's witness, Mr. Patrick J. McCullagh, that this Court found out that W. C. Imports, Inc., and Lido Export, Inc., are closely related to each other, if not, one and the same. Said, he:

DIRECT EXAMINATION BY ATTY. BANIQUED

Q. Mr. Witness, you said that you are the business manager of W.C. Imports, is that correct?

A. That is correct.

(T.S.N. June 28, 1993 Hearing, p. 6)

x x x x x x x x x

Q. What other entities if any are you presently connected with Mr. Witness other than W.C. Imports?

A. I am President and Director of Ashling Corporation, a California based U.S. corporation, which is the 100% owner of W.C. Imports and I am also director of Metonic Investments, Ltd. and Director of Lido Export, Inc. Philippine Investment. (Underscoring supplied; ibid., p. 7)

x x x x x x x x x

Q. I am showing you Mr. Witness, these two separate documents entitled memorandum of understanding regarding non-competition agreements and related agreements which earlier had been identified and marked as Exhibits G and H for the Petitioner. Are these the memorandum of understanding that you were referring to earlier?

A. Yes , sir.

Q. There are signatures appearing at the end of these agreements, do you recognize these signatures?

A. Yes, sir.

Q. Whose signatures are those?

A. On Exhibit G, the signature on G-1 is my signature, G-2 is my signature as President of W.C. Imports, G-3 is my signature as director of Metonic and G-4 is my signature as President of Lido Export, Inc. and the same applies to Exhibit H-1, H-2, H-3, H-4 (Underscoring supplied; ibid., pp. 18-19)

From the foregoing testimony, it can be safely deduced that Petitioner is indeed one and the same with W.C. Imports or at the very least closely related to each other. And for tax purposes, the separate corporate entity may be disregarded "where it serves but as a shield for tax evasion." (**Commissioner of Internal Revenue vs. Norton & Harrison Company**, August 31, 1964, SCRA 715) And in the case of **Liddell & Co., Inc. vs. Collector of Internal Revenue** L-9687, June 30, 1961, it was held thus:

> 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. as a matter of formality.

x x x x x

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 vs. 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 serves 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".

"x x x 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.

"x x x to allow a taxpayer to deny 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.)

We are therefore inclined to believe that the same jurisprudence is applicable in the case at bar. This observation is corroborated by the fact that "Lido

Export, Inc. is a major exporter virtually 97% of its business was exported to W.C. Imports..." (T.S.N. June 28, 1993 Hearing, p. 28). Such being the case, We cannot accept as viable the Thesis of the Petitioner that "Lido Export, Inc. did not stand to derive any economic benefit from the said non-competition agreements, which is why the agreement was subsequently rescinded and the responsibilities were entirely to be paid by W.C. Import which stood to gain full benefit from non-competition agreements..." (T.S.N. p. 28)

> Q. Why do you say that it was W.C. Imports that stood to solely benefit and in fact benefitted from this non-competition agreements?
>
> A. Each of the spouses Cromwells resided in the State of California in the United States and stood to offer no threats to us from an economic benefit to the performance of Lido Export, Inc. nor for that matter the performance of Metonic Investments. W.C. Imports as a marketing sales design organization within the United States clearly stood to benefit from non-competition agreements due to goodwill that was built which Cromwells acquired to their sale of W.C. Imports to the Ashling Corp. (ibid., p. 30-31).

This is difficult to believe. For sure, Lido Export, Inc. had benefitted from the non-competition agreements since it was the sole manufacturer of the goods which W.C. Imports sold and of which the latter was the only entity which marketed the products of the former. In fact, 97% of the goods which the Petitioner manufactured are sold exclusively by W.C. Imports. Certainly, it would stand benefitted.

And, furthermore, as if to seal the fact that Petitioner is one and the same with W.C. Imports for tax purposes, the alleged Sanwa Bank standby Letter of Credit which allegedly proved "that spouses Cromwell were paid the consideration under the Non-competition Agreements not by petitioner but by W.C. Imports, Inc. who opened the standby LC in favor of the Cromwells" (Petitioner's Offer of Evidence, CTA Records, p. 185) was in the name of "CLARK & TREVITHICK TRUST ACCOUNT/METONIC - 800 WILSHIRE BLVD. - 13th FLOOR, LOS ANGELES, CALIFORNIA 90017," as Applicant, with the following inscriptions on its face:

> 1. A statement signed by ROBERT H. CROMWELL and/or VIRGINIA J. CROMWELL certifying that the amount shown on the Draft represents a sum due and payable to ROBERT H. CROMWELL and/or VIRGINIA J. CROMWELL under either of the following agreements:
>
> > (1) Non-competition Agreement, dated April 14,1987, by and among ROBERT H. CROMWELL, LIDO EXPORT, INC. and METONIC INVESTMENTS LIMITED
> >
> > 2) Non-competition Agreement, dated April 14,1987, by and among VIRGINIA J. CROMWELL, LIDO EXPORT, INC. and METONIC INVESTMENTS, LIMITED.

2. No drawing shall be dated prior to March 31, 1988.

- Partial Drawings Not Allowed.

(Exhibit P; Underscoring supplied)

Nothing on the document's face would give us even a hint that it was really W.C. Imports, Inc. which paid the Cromwells under the Sanwa Bank Standby Letter of Credit. If it were, as Petitioner alleged, then logically, <u>they must be one and the same.</u>

Having clearly established that the Petitioner and W.C. Imports, Inc. are, for tax purposes, considered one and the same, then the argument of the Petitioner that the $250,000.00 "was merely accrued but was never in fact paid by Petitioner, hence, not subject to withholding tax" no longer holds water and its discussion, immaterial. Such being the case, the doctrine laid down in the case of **Mar Fishing Company, Inc.**, (CTA Case No. 4287, Oct., 4, 1991) relied upon by Petitioner is inapplicable. In the above-cited case of the Petitioner, it was, of course, presupposed that the doctrine of separate corporate entity has not been pierced, contrary to the findings of this Court in the case at bar --- herein Petitioner being found to be one and the same with W.C. Imports, Inc. Hence, the difference.

As to the allegation that the consideration for the covenant not to compete is considered income derived from the United States and, as such, not subject to Philippine withholding tax since the payees are non-resident aliens" is, to say the least, a distorted conclusion. Well established is the fact that it was the Petitioner which paid the Cromwells as sourced from an income within the Philippines. Only a prejudiced mind of the Petitioner can ever think of such an argument twisted out of its true import.

Hence, pursuant to Section 22 (b) of the Tax Code, We find the Petitioner liable to withhold the tax equal to 30% of the income derived by nonresident aliens not engaged in trade or business within the Philippines. The above pertinent provision is hereby quoted, thus:

> Sec. 22 *Tax on nonresident alien individuals* -
>
> (a) x x x x x x x x x
>
> (b) *Nonresident aliens not engaged in trade or business within the Philippines.* There shall be levied, collected and paid for each taxable year upon the entire income received from all sources within the Philippines by every nonresident alien individual not engaged in trade or business within the Philippines as interest, dividends, rents, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual or periodical or casual gains, profits, income, and capital gains (except capital gains realized from

> buying and/or selling shares of stock of Philippine corporations listed in the dollar or any acceptable Foreign Currency Board of any stock exchange), a tax equal to 30% of such income: *Provided*, That capital gains realized from sales of shares of stocks in any domestic corporation and real property shall be subjected to the tax prescribed under subsections (d) and (e) of Section 21.

As to the other issue on whether or not Petitioner is liable to pay deficiency final withholding tax on dividend payment, We find again for the Respondent.

Petitioner's allegation that "the interests were paid by petitioner on a valid and genuine indebtedness incurred in pursuit of petitioner's trade or business" (Petition for Review, p. 7) miserably failed to convince this Court. Petitioner presented the alleged promissory notes supposedly covering the amount involved, yet, the amounts do not tally with the financial statement submitted by the company. The first promissory note amounted to P351,000.00 (Exh. J) and the other one amounted to P322,500.00 (Exh. K) but the amount involved in the financial statement is only P657,608. There is indeed a discrepancy of almost P16,000.00 which by no means is a mathematical error. This leads Us to believe that the amount of P657,608 is therefore, not an indebtedness but a cash dividend payment subject to a final withholding tax.

WHEREFORE, in all the foregoing, the Petition for Review is hereby **DENIED** and Petitioner is ordered to pay the amount of P3,007,633.82 as deficiency final withholding tax on non-resident stockholders and the sum of P2,912.19 as deficiency final withholding tax on cash dividends, plus 25% surcharge and 20% annual interest from May 11, 1990 up to the full payment thereof.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

MANUEL K. GRUBA
Associate Judge

CERTIFICATION

I hereby certify that the this decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13 Article VIII of the constitution.

ERNESTO D. ACOSTA
Presiding Judge