action also extinguished the civil action. The motion was denied, but at the pre-trial, the defense invoked prescription of the action, and the trial court dismissed the case. The heirs of Marcia (Laura Corpus, widow, and the Marcia children) took the case[16] to the Supreme Court. The Tribunal, aside from ruling on the question of prescription, decided that the civil action could not prosper under Article 33 of the Civil Code, on the ground that imprudence was the crime committed and not the homicide and physical injuries and imprudence is not included in said Article 33. The appeal was dismissed. The question then is: What is the remedy of the heirs to collect damages? Your answer is as good as mine.

[16] Corpus vs. Paje, supra.

The Doctrine Of Piercing The Veil Of Corporate Fiction: Review And Analysis Of Philippine Supreme Court Decisions From Willets To Ramirez

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I. STATEMENT OF THE INQUIRY

The rule in Corporation law is that the corporation has a personality distinct from the members and stockholders composing it. The basis of the separate existence is found in Section 2 of our Corporation law providing that "a corporation is an artificial being created by operation of law, having the right of succession and the powers, attributes and properties expressly authorized by law or incident to its existence." The personality of a corporation is artificial rather than natural. It is a legal fiction.

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The separate and distinct personality of the corporation from its stockholders is, in some exceptional cases, disregarded and set aside. Such instances are called piercing the veil of corporation fiction.

It is this doctrine of piercing the veil of corporate fiction that we shall examine. The study proposes to examine the grounds for disregarding corporate fiction recognized in the Philippines. A case-to-case approach is hereby adopted, followed by an analysis of the principles running through said cases.

II. REVIEW OF THE CASES

1. *Arnold v. Willets and Patterson Ltd.*[1]

The Philippine Corporation Law (Act 1459) took effect on April 1, 1906. The first Philippine Supreme Court decision which resorted to the doctrine under study was rendered in 1923.

A partnership between Willets and Patterson was dissolved when Patterson retired. Willets became the sole owner of its assets. For convenience of operation and to serve his own purpose, Willets organized a corporation under California laws with principal office in San Francisco and by which he subscribed for and became the exclusive owner of all the capital stock, except for a few shares for organization purposes only, and the name of the firm was used as the name of the corporation. A short time later, Willets came to Manila and organized a corporation called Willets and Patterson, Ltd. Again he subscribed for all of the capital stock, except the nominal shares necessary to qualify the directors.

Plaintiff Arnold's compensation as agent of the corporation in the Philippines was agreed to in a letter-contract signed by Willets in the name of Willets and Patterson, Ltd. A suit was filed by Arnold raising the issue whether that contract was binding on the corporation. The Supreme Court ruled in the affirmative, on the ground that the contract was signed by Willets, the owner of all the stocks, the force and dominant power which controlled them.

2. *Koppel (Phil.) Inc. v. Yatco.*[2]

The next case came after the war. It involved facts typical of modern corporate business—the parent and subsidiary corporations set-up.

[1] 44 Phil. 634 (1923).
[2] 77 Phil. 496 (1946).

Koppel (Phil.) Inc. was a domestic corporation, the shares of which were all owned by Koppel Industrial Car & Equipment, Co., a Pennsylvania, U.S.A. corporation. Specifically, 995 of its 1,000 shares were thus owned. The rest, 5 shares, were owned by officers of Koppel (Phil.) Inc. The aforesaid Koppel (Phil.) Inc. was a duly licensed commercial broker in the Philippines. Koppel-Pennsylvania, on the other hand, was a foreign corporation not authorized to do business in the Philippines.

Sales of equipment were made by Koppel-Pennsylvania in the Philippines through Koppel (Phil.) Inc., purportedly as broker. The BIR assessed on Koppel (Phil.) Inc. merchant sales tax, considering Koppel (Phil.) Inc. as the same as Koppel-Pennsylvania.

The Court of First Instance decided against Koppel (Phil.) Inc., dismissing its claim for taxes paid under protest. Appeal was taken to the Supreme Court.

The tax consequences were: If Koppel (Phil.) were regarded as a broker in the transactions in question, only broker's tax of 4% of its share in the sales would be due. Such share amounted to ₱132,201.30. On the other hand, if Koppel (Phil.) is regarded as one and the same as Koppel-Pennsylvania, 1-1/2% merchant's sales tax would be chargeable *on the gross sales* which amounted to ₱3,772,403.82. The difference in tax due was ₱64,122.51, for the years 1929 to 1932.

The following facts were established: (1) Koppel-Pennsylvania totally owned the shares of Koppel (Phil.); (2) Koppel (Phil.) acted as agent of Koppel-Pennsylvania, and no other; (3) Koppel (Phil.) bore incidental expenses and even cable expenses of Koppel-Pennsylvania; (4) Koppel (Phil.)'s shares in the profits from the transactions were determined solely by Koppel-Pennsylvania; (5) Koppel-Pennsylvania instructed its banks not to protest unpaid drafts but refer them to Koppel (Phil.); (6) Koppel (Phil.) supplied the orders itself if it had the stocks; (7) Koppel (Phil.) made up for the deficiencies in stocks delivered to the buyer; (8) The sales were perfected in the Philippines.

The Supreme Court affirmed the decision of the Court of First Instance. It ruled that Koppel (Phil.) was a mere branch, subsidiary, or agency of Koppel-Pennsylvania. It emphasized that the decision of the lower court, which it affirmed, did not deny appellant legal personality for any and all purposes, but held that in the transactions involved, public interest and convenience would be defeated and tax evasion perpetrated, unless resort is had to the doctrine of disregard of corporate fiction. There was no ruling as to

separate corporate personality in other cases and for other purposes, the Supreme Court stated. It added that the rule or principle is the same whether the "person" be natural or artificial—if a corporation is the mere *alter ego* or business conduit of *a person*, it may be disregarded[3]

The Supreme Court cited U.S. cases the thrust of which is: Corporate existence will be disregarded where a corporation is so organized and controlled and its affairs are so conducted, as to make it merely an instrumentality or adjunct of another corporation;[4] and recognizing the legal principle that the corporation does not lose its entity by the ownership of the bulk or even the whole of its stock by another corporation,[5] yet, the courts will look beyond mere artificial personality which incorporation confers, and if necessary to work out equitable ends, ignore corporate forms.[6]

The Supreme Court then, applying the principle to the facts of the case, ruled, thus: So far, as these sales are involved or concerned, Koppel (Phil.) and Koppel- Pennsylvania are one and the same; or, as regards those transactions, the former corporation is a mere branch, subsidiary, or agency of the latter. This is *conclusively* borne out by the fact that the shares in the profits of Koppel (Phil.) were ultimately left to the unbridled control of Koppel-Pennsylvania. This is not conceivable if Koppel (Phil.) was intended to function as a *bona fide* separate corporation. Evidently, Koppel-Pennsylvania made use of its 99.5% ownership of Koppel (Phil.) "to control the operations of the latter to such an extent that it had a final say even as to how much should be alloted to said local entity in the so-called sharing in the profits." Neither could it be conceived how Koppel (Phil.) could avoid effectively from being so dominated and controlled. A set-up like this results in dominance not only in the *selection* of the board, but more often than not, in the *action* of the board as well.[7] Furthermore, in its corporate officers, Koppel (Phil.) had a resident Vice-President, implying that there is a non-resident Vice-President, which is not proper of a regular domestic corporation.[8]

The Supreme Court found the above even strengthened by the following facts: Plaintiff charged Koppel-Pennsylvania no more than the actual cost of merchandise allegedly its own, used to complete deficiencies of shipments made by said parent corporation. This would not be the case if Koppel

[3] *Op. cit.*, at pp. 504-506.
[4] *Ibid.*
[5] Citing Monongahela Co. v. Pittsburg Co., 196 Pa. 25. 46 Atl. 99. 79 Am. St. Rep. 685.
[6] Citing Colonial Trust Co. v. Montello Brick Works. 172 Fed 310.
[7] *Koppel (Phil.) Inc. v. Yatco*, supra Note 2, at pp. 508-509.
[8] *Ibid.*, p. 509.

(Phil.) had acted in such transactions as an entirely independent entity doing business for profit, with the American concerned. *They departed from the ordinary course of business.* No attempt was made to explain why. Plaintiff was charged by the American corporation with the cost even of the latter's cables.

All these prompted the Supreme Court to conclude:

> "Far from disclosing a real separation between the two entities, particularly in regard to the transactions in question, the evidence reveals such a commingling and interlacing of their activities as to render even incomprehensible certain accounting operations between them, except on the basis that the Philippine corporation was to all intents and purposes [as far as these transactions were concerned] a mere subsidiary, branch or agency of the American parent entity."[9]

The Philippine corporation's indifference to profit allocation was again stressed as something understandable only on the basis that it was a mere subsidiary, branch or agency of the American corporation.

3. *Gregorio Araneta, Inc. v. Tuason De Paterno.*[10]

Paz Tuason sold lots to Gregorio Araneta, Inc. Subsequently, a suit was filed by Gregorio Araneta, Inc. against Paz Tuason for compelling delivery of clean title of said lots. The defense raised the allegation that the sale was made to an agent of the seller, because Jose Araneta, President of vendee corporation, acted as agent of Paz Tuason. Defendant contended that, therefore, the corporate fiction should be disregarded, the sale should be considered as one made to an agent of the seller, and thus, not valid.

The Court of First Instance ruled that hypothetically admitting that Jose Araneta was the agent of Paz Tuason, Gregorio Araneta, Inc. is a distinct person from its President and stockholder. Appeal was taken to the Supreme Court by Paz Tuason.

Affirming the Court of First Instance, the Supreme Court ruled that corporate fiction in this case will not be disregarded because the corporate entity was not used to circumvent the law or perpetrate fraud. The Supreme Court found that: (1) Gregorio Araneta, Inc. entered into the contract *for itself and for its own benefit as a corporation;* (2) that the roles of the parties were fully revealed to each other. There was no reason there to suppose that Paz Tuason would not have gone ahead with the sale if she knew Jose Araneta was the President of the vendee corporation; (3) the

[9] *Ibid.*, p. 510
[10] 91 Phil. 786 (1952).

principle invoked is resorted to by courts as a measure of protection against deceit and not to open the door to deceit. In the present case, it would pave the way to evasion of legitimate commitment of the seller.

4. *La Campana Coffee Factory, Inc. v. Kaisahan ng Mga Manggagawa sa La Campana.*[11]

Two corporations, a coffee factory and starch factory, were owned by Tan Tong [Tantongco] and his family exclusively. Both corporations had one office, one management, and one payroll. Laborers of both concerns were interchangeable, that is, laborers from the starch factory were sometimes transferred to the coffee factory and vice-versa. The coffee factory purportedly had only 14 laborers. The starch factory had more than the 31 laborers required by the law for the Court of Industrial Relations to acquire jurisdiction. The issue was raised whether the CIR had jurisdiction over a dispute involving the coffee factory.

The Supreme Court ruled that the fiction of corporate existence should be disregarded as "in reality, they [the two companies] are but one", and the same "is but a device to defeat the ends of the law".[12]

5. *Behn, Meyer & Co. v. Hongkong & Shanghai Banking Corp.*[13]

On August 16, 1939, a bill of exchange for £805 (₱7,501.48) was drawn by Behn, Meyer, & co., a foreign corporation (Javanese) doing business in the Philippines, on Arnold Otto Meyer of Hamburg, Germany in connection with its shipment of pressed copra cake aboard S.S. "Naumburg". Said bill of exchange was payable in 60 days' sight to Hongkong-Shanghai Banking Corporation, documents to be delivered against acceptance. The S.S. "Naumburg" left Manila for Hamburg on August 17, 1939 but did not complete its voyage, and took refuge in the port of Sourabaya, Netherlands East Indies, due to the outbreak of the war.

Payee bank was able to send the original and duplicate of the bill of exchange to its New York office, together with the shipping documents. On September 15, 1939, however, the German Steamship Agencies (P.I.), Inc., representing in the Philippines the vessel's owner (Hamburg-Amerika Linie), issued a circular stating that cargo loaded from Manila to Europe, to U.S.A., and way ports on board Hamburg-Amerika Linie vessels then lying at ports of refuge may already be delivered provided full sets of the original

[11] 93 Phil. 160 (1953).
[12] *Ibid.*, p. 166.
[13] G. R. No. L-5537, May 29 1953.

bills of lading must be surrendered. Payee bank thereupon cabled its New York office to deliver the bills of lading covering the copra cake to the Hamburg-Amerika Linie in New York, which was done on September 26, 1939.

The New York office of payee bank forwarded to its London office the original of the bill of exchange without the bills of lading but with a declaration as to its surrender aforementioned. Said bill of exchange and declaration was finally presented to drawee Arnold Otto Meyer for acceptance on October 26, 1939. Said drawee refused to accept it on the ground that the shipping documents were not attached.

A suit between the drawer and payee bank ensued wherein the issue was whether payee bank properly presented the bill for acceptance so as to have recourse to drawer. The Court of First Instance held there was improper presentment for acceptance. The Supreme Court affirmed.

Among others, the affirmance was based on the refusal of the Supreme Court to pierce the veil of corporate entity of a subsidiary. At length, we quote:

"Defendant-appellant [payee bank] claims that it should not be blamed for not delivering on time the bills of lading to the drawee because it merely complied with the instructions contained in the circular. And it claims that, appellant for having complied with said instructions, plaintiff-appellee [drawer] cannot disclaim responsibility under the draft because there are circumstances which seem to indicate that the same was issued with the knowledge and approval of said appellee. Thus, it is claimed, plaintiff-appellee, drawer of the draft in question, is the agent of the drawee in the Philippines. The S.S. "Naumburg" is owned by a corporation of which the representative in the Philippines is the German Steamship Agencies (P.I.) Inc. *The latter company is a subsidiary corporation of plaintiff-appellee as evidenced by the fact that its corporate name bears the description "formerly Behn, Meyer & Co., and plaintiff is one of its incorporators and managing director. And plaintiff-appellee and said companies are managed by the same officials.* In other words, the implication was drawn that while the circular adverted to was issued by the owner of the ship, or its representative, *it must have been issued with full knowledge of, and in collusion with, plaintiff-appellee considering their close juridical relation.*

"We do not subscribe to this sweeping implication. While there may be business relations between the drawer, the drawee and the shipping company, there is no evidence whatsoever of any collusion or community of action on their part to cause prejudice to defendant-appellant in this particular transaction. The contrary is true. Thus, it appears that the German Steamship Agencies (P.I.) Inc., is a domestic corporation organized under the laws of the Philippines. The appellee in turn is a corporation organized under the law of

Java, whereas the steamer "Naumburg" is owned by a German corporation known as Hamburg-Amerika Linie. The circular was issued by the German Steamship Agencies (P.I.) Inc., whose head office was at Shanghai, merely in compliance with the instruction received from the latter. And the circular was issued not only in contemplation of the cargo in question but with reference to all the shipments that were then loaded on board the ship. These circumstances, in the absence of any clear showing to the contrary, reject any idea of collusion or bad faith on the part of the drawer, drawee and the shipping company."

6. *Marvel Building Corporation v. David.*[14]

Maria B. Castro and ten others incorporated the Marvel Building Corporation. A set of circumstances pointed to the fact that the other incorporators were mere dummies of Castro. The Bureau of Internal Revenue assessed on Maria B. Castro war profit taxes in the amount of ₱3,593,950.78 for three properties formerly in the name of Castro, but already transferred in the name of the corporation.

The Supreme Court upheld the assessment on the findings that the corporation was a mere shell or *alter ego* of the taxpayer as it appeared that she had enormous profits and accordingly had the motive to set up such a title holding shield; that duplicate stock certificates had been issued to various purported stockholders lacking the means to pay their alleged subscriptions and no receipts issued for subscriptions paid; that no stockholders' or directors' meeting was held; that the books of account treated everything as belonging to and controlled by the taxpayer Castro.

7. *Madrigal Shipping Co., Inc. v. Ogilvie.*[15]

This case involves a suit by crew members of a ship to recover salaries and subsistence payments. Defendant Madrigal Shipping Co., Inc. alleged that it had no juridical personality and that the owner of the ship of which plaintiffs were the crew members was the corporation Madrigal & Co., not the defendant.

The Supreme Court ruled that the defendant Madrigal Shipping Co., Inc., has a juridical personality as shown by the evidence of incorporation, erroneously excluded by the Court of First Instance. Secondly, it said:

"Again, granting that it was not the Madrigal Shipping Co., Inc. that owned the 'SS Bridge', but the Madrigal & Co., a corporation with a juridical personality distinct from the former, yet as the former was the subsidiary of the latter, and that the former was a

[14] 94 Phil. 376 (1954).
[15] 104 Phil. 748 (1958)

business conduit of the latter, as found by the Court of Appeals, the fiction of corporate existence may be disregarded and the real party ordered to pay the respondents their just due."

8. *Tantongco v. Kaisahan ng Mga Manggagawa sa La Campana [KKM]*[16]

The present case is an aftermath of the *La Campana* case previously mentioned. As stated, there were two corporations involved: the La Campana Coffee Factory and the La Campana Starch Factory. After the Supreme Court decided in the former case that the Court of Industrial Relations had jurisdiction over the case, the same proceeded to trial in said Court of Industrial Relations. In the course of the proceedings there, Ramon Tantongco, the supposed owner and manager of both companies, died. Subsequently, the judgment was rendered against said companies. Execution of said judgment was ordered against said companies and/or the administrator of Ramon Tantongco, namely, Ricardo Tantongco. Said execution was sought to be enforced against said administrator in said proceedings. On the other hand, said administrator sought to quash the order against him on the ground that the claim against Ramon Tantongco, deceased, should be prosecuted in his estate proceedings.

Administrator Tantongco filed in the Supreme Court a petition for certiorari and prohibition to restrain the Court of Industrial Relations from enforcing through contempt orders the execution in question. Administrator Tantongco contended that the Supreme Court having considered the two corporations without separate personalities, judgment should be deemed rendered against Ramon Tantongco *personally* and thus should be prosecuted as claims in his estate proceedings.

The Supreme Court ruled that notwithstanding its decision in the former case, the two companies have separate personalities from Ramon Tantongco even if his family was practically the owner of both. It stated that the disregard of corporate fiction adverted to was only to avoid the technicality advanced in the former case to defeat the jurisdiction of the Court of Industrial Relations. For other purposes, therefore, the corporate fiction is still maintained. Besides, the Supreme Court added, the administrator was in estoppel, having previously asserted the separate personality of said corporation.

9. *Laguna Transportation Co., Inc. v. SSS*[17]

From 1949, a partnership engaged in the business of transportation as common carrier. It was converted to a

[16] 106 Phil. 198 (1959).
[17] 107 Phil. 833 (1960).

corporation in 1956. The Social Security System considered the corporation as under the SSS as of the year 1957 pursuant to Republic Act 1161, on the ground that it had been operational the last two years, counting the operation of the partnership. The corporation contended that it is distinct from the partnership and therefore is not yet covered by the SSS.

The Supreme Court ruled that the corporation's separate existence is a legal fiction for purposes of convenience and to subserve the ends of justice. The petitioner's argument, the Supreme Court continued, if adopted, would defeat, rather than promote the ends for which the Social Security Act was enacted. Said the Court: "An employer could easily circumvent the statute by simply changing his form of organization every other year...."

The Supreme Court further pointed out that no mention was made that the lines and equipment of the partnership were sold and transferred to the corporation, thus, clearly indicating that there was merely a change in the *form* of organization, but no transfer *in fact* of the interest.

10. *Yutivo Sons Hardware Co. v. Court of Appeals and Collector of Internal Revenue.*[18]

This case again involves a corporation owned by another corporation.

GM cars and trucks were imported by Yutivo, a domestic corporation. Yutivo thereafter sold them wholesale to Southern Motors, Inc., its subsidiary. Sales taxes were paid by Yutivo on this first sale. Southern Motors sold the vehicles to the public, retail. The National Internal Revenue Code imposes sales tax only on the first sale.

The Collector of Internal Revenue sought to impose the sales tax not on Yutivo's sale to Southern Motors but on Southern Motor's sale to the public, on the ground that Yutivo and Southern Motors were one and the same corporation. The difference in taxes would amount to ₱2,215,809.27 in all.

Yutivo contested the assessment by filing suit in the Court of Tax Appeals, alleging that there was no valid ground to disregard Southern Motor Corporation's separate personality.

The Court of Tax Appeals sustained the Collector of Internal Revenue. It found that there was no legitimate or *bona fide* purpose in Southern Motor's organization; that

[18] 1 SCRA 160 (1961).

the apparent objective of its organization was to evade payment of taxes; and that it was owned, or majority of the stocks thereof were owned, and it was controlled, by Yutivo and is a mere subsidiary, branch, adjunct, conduit, instrumentality or *alter ego* of the latter.

Appeal was taken to the Supreme Court by Yutivo.

The Supreme Court first stated the rule as follows:

"It is an elementary and fundamental principle of corporation law that a corporation is an entity separate and distinct from its stockholders and from other corporations to which they may be connected. However, 'when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime, the law will regard the corporation as an association of persons, or in the case of two corporations merge them into one.' (Koppel [Phil.] Inc. v. Yatco, 77 Phil. 496, citing 1 Fletcher's Cyclopedia of Corporations, Perm. Ed., pp. 135-136; United States v. Milwaukee Refrigeration Transit Co., 140 Fed. 247, 255 *per* Sanborn, *J*). *Another rule is that,* when the corporation is the 'mere alter ego and business conduit of *a person,* it may be disregarded.' (Koppel (Phil.) Inc. v. Yatco, *supra*)."[19]

The Supreme Court then stated its ruling in the case, which consisted of several parts. The first point ruled by the Supreme Court was that *Southern Motors was not fraudulently organized.* It found that the Court of Tax Appeals was not justified in finding Southern Motors organized for no other purpose than to defraud the government of its lawful revenues. For at the time Southern Motors was organized, Yutivo was not the importer of GM cars, but rather, it was GM Overseas Corporation, so Yutivo then had no sales tax liability thereon; hence, Southern Motors was not organized to evade Yutivo's tax liability on GM imported cars. Newspaper clippings and rumors of GM Overseas Corporation's intention to withdraw from the Philippines, was found to be not supported by the records but mere speculations. Said the Court: "The intention to minimize taxes, when used in the context of fraud, must be proven to exist by clear and convincing evidence amounting to more than mere preponderance and cannot be justified by the mere speculation. This is because fraud is never likely to be presumed."[20]

The second point of the Supreme Court's ruling was that Southern Motors was organized and operated without the intention to evade sales taxes. Several reasons were

[19] *Ibid.*, pp. 165-166, emphasis supplied.
[20] *Ibid.*, p. 167.

given by the Supreme Court in support of this finding, namely:

a) Yutivo and Southern Motors sales were in the open, not hidden. Yutivo merely continued GM Overseas Corporation's method, started long before GM Overseas Corporation withdrew from the Philippines;
b) Republic Act 594 effective February 16, 1951 imposed advance sales tax on importers based on the landed cost of the imported article; if Southern Motors were organized merely to save or avoid sales taxes, its reason for existence ceased when Republic Act 594 took effect. Yet, Southern Motors continued to exist and operate in pursuit of business purposes for which it is organized;
c) The National Internal Revenue Code, Sections 184 to 186, impose sales tax "only once on every original sale, barter, exchange....to be paid by the manufacturer, producer or importer." The Supreme Court reasoned: "A taxpayer has the legal right to decrease the amount of what otherwise would be his tax or altogether avoid them by means which the law permits. x x x any legal means used by the taxpayer to reduce his tax are all right."[21]

The Supreme Court then came to the third point of its ruling. It held that: The Southern Motors, however, was indeed actually owned and controlled by Yutivo as to make it a mere subsidiary or branch of the latter created for the purpose of selling the vehicle at retail and to maintain stores for spare parts as well as repair shops.

In support of this finding, the Supreme Court pointed out the following:

(a) Southern Motors was *owned* by Yutivo.[22]
(b) Southern Motors was *controlled* by Yutivo.[23]

As circumstances pointing to the aforesaid control by Yutivo of Southern Motors, the following were mentioned by the Court:

(1) Southern Motors was under Yutivo control by virtue of a management contract.
(2) The controlling majority of Yutivo is also the controlling majority of Southern Motors.
(3) The officers of both corporations are identical.
(4) There is a common comptroller for both corporations.

[21] *Ibid.*, p. 168.
[22] *See ibid.*, pp. 170-172.
[23] See *ibid.*, pp. 172-174.

(5) As a result of the foregoing, the business, finance and management policies of both corporations could be directed towards common ends.
(6) All cash assets of Southern Motors were handled by Yutivo and all cash transactions of Southern Motors were actually maintained by Yutivo.
(7) Any and all cash payments for Southern Motors charges were made by Yutivo out of Southern Motors deposit with Yutivo, under authority of Yutivo's corporate officers, without furnishing Southern Motors a copy thereof.
(8) Detailed records of cash disbursements were covered by Yutivo and Southern Motors had only summary records.
(9) Southern Motors and Southern Motors' branches treat Yutivo-Manila as their head office or "Home Office."
(10) Arrastre charges on imported cars were charged against Southern Motors, as well as overtime charges for unloading of cars.
(11) Management fees due from Southern Motors to Yutivo were treated not as income but as "reserve for bonus" or liability reserve.

In short, said the Court, at all times, *Yutivo, through officers and directors common to it and Southern Motors, exercised full control over the cash funds, policy, expenditures and obligations of the latter." Southern Motor's operations and existence were dependent on Yutivo.*[24]

The result of this third finding is: "Southern Motors being but a mere instrumentality or adjunct of Yutivo, the Court of Tax Appeals correctly disregarded its technical defense of separate corporate entity in order to arrive at the true tax liability of Yutivo."[25]

The resulting disposition of the suit by the Supreme Court may be summarized as follows:

(a) The sales made by Southern Motors are in substance by Yutivo;
(b) This does not necessarily establish fraud or lawful finding of a false or fraudulent return. A taxpayer may diminish his tax liability by means which the law permits. The fact that the medium he chose which he believed sufficient is held insufficient, does not render it fraudulent, hence, no surcharge for fraud should be imposed.

[24] *Ibid.*, p. 173.
[25] *Ibid.*, p. 174.

(c) Taxes already paid by Yutivo should be deducted from the tax liability assessed.
(d) Final result—Yutivo's deficiency tax is ₱820,549.91.

11. *M. McConnel, et al. v. Court of Appeals.*[26]

A corporation, Park Wright, Co., Inc., used Padilla's lot without the latter's knowledge or consent.

Forcible entry suit was filed against the corporation by Padilla. Judgment was rendered against it, ordering it to pay damages in the amount of ₱7,410.00 plus interest. Later, this amount grew to ₱11,732.00. The corporation was found without asset other than ₱550.00, deposited in court. Applying this, the deficiency of ₱11,182.50 remained.

Padilla sued the corporation and its past and present stockholders to recover the balance. The Court of First Instance denied recovery. The Court of Appeals reversed, finding that the corporation was the mere *alter ego* or business conduit of the stockholders for their own benefit.

On appeal to the Supreme Court, the latter held that the corporation was used as an *alter ego* or business conduit for the sole benefit of the stockholders and hence, the fiction should be disregarded. Again, the Supreme Court stated that mere ownership of all and nearly all of the stocks does not make it a mere business conduit, *but in this case, the operation of the business corporation was so merged with those of the stockholders as to be practically indistinguishable.* Furthermore, they had the *same office*, the *funds were held by the stockholders*, and the *corporation had no visible assets.*

12. *Liddell and Co., Inc. vs. Collector of Internal Revenue.*[27]

A domestic corporation, Liddell & Co., Inc., was established in 1946. Frank Liddell was owner of 98% of its capital stock.

Subsequently, Liddell Motors, Inc. was organized in 1948. The sole incorporator, except for 4 shares, owned by 4 other incorporators with a single share each, was Frank Liddell's wife. No proof was adduced that she could provide money for her subscription.

From 1946 to 1948, Liddell & Co., imported in retail Oldsmobile and Chevrolet cars and GMC and Chevrolet trucks.

[26] 1 SCRA 722 (1961).
[27] 2 SCRA 632 (1961).

Starting 1949, Liddell & Co. stopped retailing cars and trucks. It conveyed them instead to Liddell Motors, Inc., which in turn sold the vehicles with a steep mark-up. Since then, Liddell & Co. paid sales taxes on the basis of the sales to Liddell & Motors, Inc., considering said sales as its original sales.

Alleging that Liddell Motors, Inc. is a mere *alter ego* of Liddell & Co., Inc., the Collector of Internal Revenue assessed sales taxes on Liddell & Co. on the basis of sales of Liddell Motors, Inc. The deficiency assessment totalled ₱1,317,629.61.

Liddell & Co. questioned the assessment in the Court of Tax Appeals. The decision of the Court of Tax Appeals was that Liddell & Co. is liable for the aforesaid deficiency assessment. Appeal to the Supreme Court followed.

The ruling of the Supreme Court was:

(1) Frank Liddell wholly owned and controlled Liddell & Co. and Liddell Motors, Inc.

(2) The fact alone that Liddell & Co. and Liddell Motors, Inc. are corporations owned and controlled by Frank Liddell is not sufficient to justify disregard of separate corporate identity of one from the other.

(3) In the present case, however, there is a peculiar consequence of the organization and activities of Liddell Motors, Inc.

(4) Said peculiar consequence is, namely, that *Liddell Motors, Inc. was the medium created by Liddell & Co. to reduce the price of the first sale and the tax liability thereof.*

(5) The taxpayer has of course the legal right to decrease by means which the law permits, the amount of what otherwise would be his taxes or altogether avoid them; *but a dummy corporation serving no business purposes but only a blind, will be disregarded.*

The Supreme Court in said decision stated that as held in *Higgins v. Smith*:[28] "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 the benefit of the transactions as the person actually taxable."[29]

[28] 308 U.S. 406.
[29] *Ibid.*, note 27, p. 641, stress ours.

The Supreme Court added: "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 and that they are practically one and the same, is to sanction a circumvention of our tax laws.[30]

The Supreme Court in another portion of the decision stated the requisite for separate personality even if two corporations are owned and controlled by the same persons:

"It is of course accepted that the mere fact that one or more corporations are owned and controlled by a single stockholder is not of itself a sufficient ground for disregarding separate corporate entities. Authorities [Burnet, Com'r v. Clarke, 287, U.S. 77 L. Ed. 397, Burnet, Com'r v. Commonwealth Improvement Co., 287 U.S. 415, 77 L. Ed.———] support the rule that it is lawful to obtain a corporation charter even with a single substantial stockholder, to engage in a specific activity, and such activity may co-exist with other private activities of the stockholder. If the corporation is *a substantial one, conducted lawfully and without fraud on another,* its separate identity is to be respected."[31]

Another principle enunciated by the Supreme Court in the present case is that the right to decrease or avoid taxes thru lawful means is recognized; but putting up a corporate blind is not countenanced by the law. Said the Court:

"As opined in the case of Gregory v. Helvering, 293, U.S. 465, 'the legal right of a taxpayer 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 [Higgins v. Smith, 308 U.S. 40§], '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."[32]

The Supreme Court, it should be noted, also held that no fraud was established in the Liddell case; surcharges for late payment were sustained but not surcharges for fraud, because the transactions were done in the open. Nonetheless, the Court disregarded the corporate fiction, because of the series of circumstances that militated against the separate and distinct personality or persons of Liddell Motors, Inc. from Liddell & Co. On this point, it said:

"We notice that the bulk of the business of Liddell & Co. was channelled thru Liddell Motors, Inc. On the other hand, Liddell Motors, Inc. pursued no activities except to secure cars, trucks and

[30] *Ibid.*, pp. 641-642.
[31] *Ibid.*, p. 640, stress ours.
[32] *Ibid.*, p. 641.

spare parts from Liddell & Co., Inc. and then sell them to the general public. These sales....for the most part were shown to have taken place on the same day.... We may even say that the cars and trucks merely touched the hand of Liddell Motors, Inc. *as a matter of formality.*[33]

13. *Palacio v. Fely Transportation Co.*[34]

An AC jeepney owned by Isabelo Calingasan and driven by Alfredo Carillo ran over Palacio's child, causing injuries, on December 24, 1952.

Subsequently, a corporation was formed, Fely Transportation, Co., with Isabelo Calingasan as President and General Manager. On December 24, 1955, the jeepney was sold to said corporation.

Palacio sued the corporation to recover on the subsidiary liability of the owner of the jeep under Article 103 of the Revised Penal Code. As a defense, it was alleged that Fely Transportation Co. is distinct from Isabelo Calingasan, who was not made party to the case.

The Court of First Instance ruled that the corporation was not liable.

On appeal, the Supreme Court reversed and regarded the corporation and Calingasan as one and the same person on the ground that Calingasan's main purpose in forming the corporation was to evade his subsidiary civil liability. As proof of this, the Court pointed out that the incorporators were Calingasan, his wife, his son Dr. Calingasan, and his two daughters. Furthermore, the corporation failed to prove it had properties other than the jeep. The corporate fiction was held to have been used as a shield for a purpose subversive of the ends of justice, and was thus pierced.

14. *San Teodoro Development Enterprises, Inc. v. SSS.*[35]

San Teodoro partnership changed its form of organization into a corporation called the San Teodoro Development Enterprises, Inc. Said corporation was organized on January 2, 1957, after the partners had agreed on December 15, 1956 to dissolve the partnership before the scheduled time for its dissolution. The partners controlled the new corporation (4 out of 8 incorporators; 5 out of 3 directors; ₱101,000.00 out of ₱150,000.00 subscribed capital; ₱24,500.00 out of ₱45,000.00 paid-up capital). On June 4, 1957, the partnership sold the

[33] Ibid., p. 639, stress ours.
[34] G. R. No. L-15121. August 31, 1962.
[35] G. R. No. L-17662. May 39, 1963.

bulk of its materials and equipment to the corporation. Subsequently, on July 19, 1957, the partnership was formally dissolved.

The SSS considered the corporation mandatorily covered by the System as of August 1, 1957. The corporation replied that it was in operation not earlier than January 2, 1957 when it was organized and thus was not covered under the law. It maintained its distinction from the partnership which operated since 1951. The administrator of the SSS however ruled that there was no substantial change involved but only a formal one, and therefore considered the two entities as one for purposes of coverage by the SSS. Appeal was taken to the Supreme Court by the corporation.

The Supreme Court held that the corporation's theory that it has a separate personality from the defunct partnership, would, if sustained, result in the evasion of statutory obligation even if it may not have been its intention to evade it, and defeat the purposes of the law. Although there was no fraud found from the facts, the Supreme Court ruled that petitioner corporation's stand would, if upheld, open the door to fraud. The decision of the SSS was affirmed.

15. *Commissioner of Internal Revenue v. Norton & Harrison, Co.*[36]

Norton & Harrison Co. is a corporation organized in 1911. Jackbilt corporation was organized on February 16, 1948. From July 27, 1948 to April 30, 1953, Norton & Harrison corporation and Jackbilt corporation had a distribution or agency agreement. The distribution or agency agreement provided that Norton corporation shall be the sole and exclusive distributor of concrete blocks manufactured by Jackbilt. During this period, or on June 10, 1949, Norton & Harrison Corporation purchased all the outstanding shares of Jackbilt corporation. Pursuant to the distribution agreement, whenever an order for concrete blocks was received by Norton corporation from a customer, the order was transmitted to Jackbilt, which delivered the merchandise directly to the customer. Payment for the goods however was made to Norton corporation, which in turn paid Jackbilt the amount charged the customer, less a certain amount as Norton corporation's compensation or profit. For example, American Builders ordered from Norton corporation 420 pieces of concrete blocks; the order was transmitted to Jackbilt; Jackbilt delivered the merchandise to American Builders; American Builders paid Norton corporation the purchase price of ₱189.00; out of this, Norton corporation paid Jackbilt ₱168.00, keeping the rest as its compensation.

[36] G. R. No. L-17618; August 31, 1964.

For transactions like this, the Bureau of Internal Revenue assessed on Norton corporation deficiency sales tax, basing it on sales by Norton corporation to the public as the original sales, instead of sales by Jackbilt to Norton corporation. Said assessment including surcharges totalled ₱32,662.90. Norton corporation contested the assessment in the Court of Tax Appeals.

The Tax Court ruled that there was no sale by Jackbilt to Norton corporation at all, only an agency transaction. The first sale was therefore that of Jackbilt to the public through the agency of Norton corporation. Hence, the Tax Court concluded, the deficiency sales tax should be imposed on Jackbilt, not on Norton corporation. Appeal was taken to the Supreme Court by the Commissioner of Internal Revenue.

The Supreme Court reversed the Tax Court and held that the separate identities of Norton corporation and Jackbilt corporation should be disregarded, due to over-all appraisal of the circumstances presented by the facts of the case, yielding to the conclusion that Jackbilt was merely an adjunct, business conduit or *alter ego* of Norton corporation.

Said the High Court:

> "It has been settled that the ownership of all the stocks of a corporation by another corporation does not necessarily breed an identity of corporate interest between the two companies and be considered as a sufficient ground for disregarding the distinct personality (Liddell and Co., Inc. v. Collector of Internal Revenue. L-9687, June 30, 1961). However, in the case at bar, we find sufficient grounds to support the theory that the separate identities of two companies should be disregarded."

The Supreme Court specified the following circumstances:

(a) Norton corporation owned all the stocks outstanding of Jackbilt, that is, of 15,000, 14,993 were owned by Norton corporation; the rest, by 7 others at one each.

(b) Norton corporation constituted Jackbilt's board of directors in such a way as to enable it to actually direct and manage the other's affairs. James E. Norton was president, treasurer, director and stockholder *of both* companies, the difference being only that his stockholding in Jackbilt was nominal or one share only. Five other nominal stockholders and directors of the Jackbilt were employees of Norton corporation.

(c) Norton corporation financed the operations of Jackbilt, using loans obtained from RFC and the Bank

of America to operate Jackbilt, giving advances without limit to Jackbilt.

(d) Norton corporation treated Jackbilt's employees as its own; it paid their salaries, gave them the same privileges as its own; service of employees in either corporation was considered in the promotion of both corporations.

(e) Compensation to the board members of Jackbilt indicate that Jackbilt is a mere department of Norton corporation; salaries and allowances came from Norton corporation except for nominal and measly sums from Jackbilt.

(f) Norton corporation and Jackbilt offices were located in the same compound.

(g) Payments were effected by one corporation for the other's accounts and vice-versa.

All these were deemed not off-set by other circumstances cited by Norton corporation, namely:

(1) The loans were pursued in the usual manner, regular course of business, to the mutual advantage of both corporations.

(2) The two corporations had separate boards of directors.

(3) Their cash assets were entirely and strictly separate.

(4) Their Cashiers, official receipts and bank accounts were distinct and different.

(5) Separate income tax returns, separate balance sheets and profit and loss statements were made by the corporations.

16. *Collector of Internal Revenue v. University of Visayas.*[37]

This case involves an educational institution and the issue was whether the income of said institution was exempt from income tax on the ground that its income did not inure to the benefit of its stockholders.

The Supreme Court pierced the veil of corporate fiction. As a result, the net income of the educational institution was deemed that of its controlling group, thereby rendering it as an income inuring to the benefit of the stockholders of said institution, hence, rendering the institution not exempt from income tax under Section 27, paragraph (e) of the National Internal Revenue Code.

The reason given by the Supreme Court was that absolute control of the corporation was exercised by the

[37] G. R. No. L-13554, decision promulgated on February 28, 1961; Resolution on Motion for reconsideration issued on October 31, 1964.

President, Mr. Gullas, and his immediate family (who held 85% of the capital stock) to an extent that warrants the conclusion that the corporate entity is but an *alter ego* or business conduit of said stockholder justifying a disregard of the corporate fiction so that the net income of the corporation may be viewed as that of the controlling group.[38] As an instance, the Supreme Court referred to the fact that at one time, the president's objection to a proposal to issue additional shares covering accumulated profits, defeated the proposal of the Board, that is, the President over-ruled the Board. Furthermore, properties of the corporation were placed in the name of the President or his wife or both.

17. *R. F. Sugay and Co. v. Reyes.*[39]

A suit was filed for compensation under the Workmen's Compensation Act Against R. F. Sugay & Co., Inc. and Pacific Products, Inc. and Romulo Sugay. Claimants, Reyes and Curata suffered burns while painting a building of Pacific Products, Inc. The Workmen's Compensation Commission found the statutory employer to be R. F. Sugay & Co., Inc.

Appeal was taken to the Supreme Court by R. F. Sugay & Co. which denied that it is the employer of the claimants and asserted that its President, Romulo Sugay, was the one who entered into a contract of administration and supervision for painting the building of Pacific Products, Inc. as agent of Pacific Products, Inc.

The Supreme Court held that the dual roles of Romulo Sugay should not be allowed to confuse facts relating to employer-employee relationship. It said: "It is a legal truism that when the veil [of] corporate fiction is made as a shield to perpetrate a fraud and/or confuse legitimate issues (here, the relation of the employer-employee), the same should be pierced. Verily, the R. V. Sugay & Co., Inc. is a business conduit of R. F. Sugay."

18. *Emilio Cano Enterprises, Inc. v. CIR.*[40]

A suit was filed in the CIR for reinstatement of an employee plus damages against Emilio and Rodolfo Cano as officers of Emilio Cano Enterprises, Inc. The suit did not include the corporation as defendant. Judgment was rendered against them, for reinstatements plus damages. Emilio Cano died after the suit was filed and judgment was rendered by the CIR trial judge, but before it was affirmed by the CIR *en banc*.

[38] Citing The *Koppel* Case, supra note 2.
[39] G. R. No. L-20451, December 28, 1964.
[40] G. R. No. L-20502, February 26, 1965.

The order of execution was directed against the corporation. A motion to quash was filed, invoking the separate personality of the corporation. The CIR denied it, appeal was taken to the Supreme Court.

The Supreme Court affirmed. Reasons: Incorporators or stockholders belong to a single family—Emilio Cano, his wife, his sons Rodolfo and Carlos and his daughter-in-law. The Court concluded that the corporation and its companies may be considered as one. It said that the corporate fiction can not be invoked as its purpose is to use it as a shield to further an end subversive of justice.[41]

Another factor considered by the Court was that Emilio Cano was sued in his official capacity; that his connection with the case was thus impressed with the representation of the corporation. The suit was in effect against the corporation. Demand for substitution of parties would be a mere technicality entailing needless delay.

19. *NAMARCO v. Associated Finance Co., Inc.*[42]

Associated Finance Co., Inc. thru its President, Francisco Sycip, entered into an agreement to exchange sugar with NAMARCO. NAMARCO complied by delivering to Associated Finance 7,732.71 bags of "Busilate" sugar 17,285.08 piculs of "Pasumil" domestic raw sugar. Associated Finance failed to deliver an agreed 22,516 bags of "Victoria"and/or "National" refined sugar in exchange.

NAMARCO sued Associated Finance and Sycip for the value of the sugar it delivered and liquidated damages.

The Court of First Instance decided against Associated Finance but dismissed the action against Sycip.

Appeal was taken by NAMARCO to the Supreme Court, the amount involving more than ₱200,000.00.

The Supreme Court's ruling was: Sycip and his wife owned ₱60,000.00 and ₱20,000.00 respectively of the outstanding ₱105,000.00 shares of Associated Finance the first and second biggest stockholders thereof; Sycip knew at the time of the agreement that Associated Finance was already insolvent; NAMARCO entered into the contract due to Sycip's fraudulent representations; Sycip testified that he regarded the contract as one in his personal capacity and even offered to pay NAMARCO (but at a lower value). Sycip had absolute control of Associated Finance's business. Associated Finance was a mere *alter ego* or business conduit; all this warrants piercing the veil of corporate fiction.

[41] Citing *La Campana*, supra note 11 and *McConnel*, supra note 26.
[42] 19 SCRA 962 (1967).

20. *Republic v. Razon.*[43]

This involves payment of income to a non-resident alien abroad not engaged in business in the Philippines. The Bureau of Internal Revenue sought to collect from Jai Alai Corporation withholding tax under Section 53, subsections (b) and (c) of the National Internal Revenue Code. The defense was that payment was not made by Jai Alai but by Madrigal & Co., corporation.

The Supreme Court ruled that payment made by Madrigal and Co. was rendered charged to the account of Vicente Madrigal. Vicente Madrigal was the controlling stockholder of Madrigal & Co. and Jai Alai corporation. The payable income was for percentage due under a management contract between Jai Alai corporation and the payee. The Supreme Court said: "Piercing the veil of corporate fiction, it can be said that said payments, albeit made in the name of Madrigal & Co., and later charged to the personal account of Vicente Madrigal, were really payments made by the Jai Alai."[44] The Jai Alai corporation was therefore held liable as withholding agent.

21. *A. D. Santos, Inc. v. Ventura Vasquez.*[45]

Suit for workmen's compensation was filed with the Workmen's Compensation Commission by a taxicab driver, Vasquez, against his employer, A.D. Santos, Inc. In his testimony, Vasquez said that his employer was Amador Santos. A. D. Santos, Inc. contended that Amador Santos is the one responsible for the claim.

The Supreme Court held that the Workmen's Compensation Commission was right in holding A. D. Santos, Inc. liable. A. D. Santos, Inc. admitted in its answer that Vasquez was its taxi driver. Regarding the testimony of Vasquez, the Supreme Court said that indeed Amador Santos was, at one time the sole owner and operator of the taxicab business that employed Vasquez, which was subsequently transferred to A. D. Santos, Inc. Said testimony, it continued, should not be allowed to confuse the facts relating to employer-employee relationship, for when the veil of corporate fiction is made as a shield to perpetrate fraud and/or confuse legitimate issues, the same should be pierced.[46]

22. *Villa Rey Transit Inc. v. Ferrer.*[47]

Jose Villarama sold two certificates of public convenience to the Pangasinan Transportation Company, Inc. (Pantranco)

[43] 20 SCRA 234 (1967).
[44] *Ibid.*, p. 246
[45] 22 SCRA 1156 (1968)
[46] Citing *Sugay* supra note 39.
[47] 25 SCRA 845 (1968).

for ₱350,000.00 with a condition, among others, that the seller (Villarama) "shall not for a period of 10 years from the date of this sale, apply for any TPU (Transportation Public Utility) service identical or competing with the buyer."

Three months thereafter, a corporation called Villa Rey Transit, Inc. (corporation) was organized. After its registration, it bought five certificates of public convenience, forty-nine buses, tools and equipment from one Valentin Fernando for the sum of ₱249,000.00. But before the purchase could be approved by the Public Service Commission, the sheriff of Manila, acting in pursuant to a writ of execution issued in favor of Eusebio Ferrer, judgment creditor, against Valentin Fernando, judgment debtor, levied on two of the five certificates of public convenience. The two certificates were sold on a public sale and Ferrer was the highest bidder. Ferrer sold the two certificates to Pantranco which obtained a provisional grant to operate under said certificates. The corporation filed with the Court of First Instance of Manila a complaint seeking the annulment of the sheriff's sale, the subsequent sale by Ferrer to Pantranco and all orders of the Public Service Commission relative to the two certificates of public convenience involved. The court *a quo* rendered judgment in favor of the corporation. On appeal, one of the issues raised was whether or not the restrictive clause in the contract entered into by Villarama and Pantranco was enforceable and binding upon the corporation.

On the assumption that the restrictive clause was valid, the Supreme Court rendered judgment in the affirmative, the corporation being an alter ego of Villarama as disclosed by the following circumstances:

(1) The finances of the corporation which are supposed to be under the control and administration of the treasurer keeping them as trust fund for the corporation were manipulated and disbursed as if they were the private funds of Villarama;

(2) His wife was an incorporator with the least subscribed number of shares and was elected treasurer of the corporation;

(3) The initial cash capitalization of the corporation of ₱105,000.00 was mostly financed by Villarama, ₱85,000.00 being covered by his personal check deposited with the First National City Bank of New York;

(4) On the ₱200,000.00 worth of shares originally subscribed by his wife, brother- and sister-in-law, there was no actual payment of ₱95,000.00 and ₱105,000.00 as appearing in the books;

(5) The ledger entries and vouchers show that Villarama had commingled his personal funds and transactions with those made in the name of the corporation; Villarama made use of the money of the corporation and deposited them to his private accounts and the corporation paid his personal accounts; gasoline purchases of the corporation were made in Villarama's name;

(6) When the corporation was in its initial months of operation, Villarama purchased and paid with his personal checks Ford trucks for the corporation.

Consequently the Supreme Court ruled that Villarama, having control over the corporation, especially in the management and disposition of its funds, "may not make use of the corporate entity as a means of evading the obligation of his covenant."[48]

23. Ramirez Telephone Corporation v. Bank of America[49]

Third-party defendant Herbosa, owner of a building located in Sta. Mesa, leased the premises to Ruben Ramirez, president of the Ramirez Telephone Corporation, whose main office in Escolta was transferred to said premises. When the unpaid rents accumulated, Herbosa presented an action for ejectment in the municipal court of Manila which was later appealed to the Court of First Instance where Herbosa obtained a favorable decision. Before the promulgation of said decision, Herbosa obtained a writ of attachment, which was served on the defendant Bank of America, ordering the garnishment of all the funds deposited in the Bank in the name of Ramirez. Said Bank replied that no such funds were deposited in the name of Ramirez. In an amended writ of attachment, with which the Bank complied, the sheriff notified the Bank of the garnishment of the interest or participation which Ramirez may have in the deposit of Ramirez Telephone Corporation to cover the amount of ₱2,400.00 owed to Herbosa. Ramirez Telephone Corporation had a deposit of ₱4,789.53, subsequently reduced by the garnishment to ₱2,389.53. The next day, said telephone company withdrew a sum of ₱1,500.00 leaving a balance of ₱889.00. On the following day the telephone company thru its president Ramirez, drew a check in the amount of ₱2,320.00 in favor of Ray Electronics but the check was dishonored by the Bank.

The telephone company instituted against the Bank, the present action for damages, the main thrust of which was that Ramirez, the defendant in the ejectment case, had no personal deposit in the Bank, the telephone company in whose name the funds were deposited being an entirely separate and distinct entity, and that as a result of the dishonor of the check, Ray Electronics cancelled the request of the company for the equipment necessary in the construction of its telephone lines resulting in the paralyzation of its operations. The lower court rendered judgment for the telephone company, ordering the de-

[48] Ibid., p. 858, citing 26 AM. Jur. 548; 18 Am. Jur. 2nd 563-64.
[49] 29 SCRA 191 (1969)

fendant Bank of pay damages without prejudice to the right of the latter to reimbursement from the third party defendant Herbosa. On appeal, the Court of Appeals reversed the lower court's judgment.

The Supreme Court favored the following facts as found by the Court of Appeals, which justify the piercing of the veil of corporate fiction in order to garnish the funds deposited in the name of the telephone company to satisfy the debts of a principal stockholder:

(1) Although Ramirez was the tenant in the lease contract entered into between the former and Herbosa, the telephone company in truth occupied the leased premises:

(2) Ramirez paid the rents with checks in the name of the telephone company, which showed clearly that Ramirez could dispose of the funds deposited by said telephone company for the payment of rents owed to Herbosa;

(3) Seventy-five per cent of the shares of the company belonged to Ramirez and his wife.

III. ANALYSIS OF THE DECISIONS

In the Philippines, the grounds for disregarding the veil of corporate entity are of two kinds: (1) The corporate entity is used to promote fraud, injustice, illegality or wrong; and (2) The corporate entity is a *mere alter ego*, business conduit, branch or agency of *a person*, natural or another corporation. These two grounds are separate. The presence of one is sufficient to warrant piercing the veil of corporate fiction.

Thus, the presence of the first ground alone—illegal use of the corporate entity—sufficed in the following cases: The *WCC cases* (*Sugay* case and *A. D. Santos* case), to evade or confuse facts so as to evade, workmen's compensation payment; the *Razon* case, to evade withholding income tax; the *Namarco* case, to evade personal liability by fraudulently contracting for and in behalf of an *insolvent* corporation; the *Cano* case, to evade or delay by technicality, execution on corporation of final judgment for reinstatement plus damages; the *Palacio* case, to evade subsidiary liability of an owner of a vehicle under the Revised Penal Code. In these cases, there was no finding that the corporation was a mere *alter ego*, business conduit or agency of the stockholders. It sufficed that the corporation was resorted to for an illegal end.

In most of these cases, the corporations was used *to escape liability already incurred.* For example, in the case of *Palacio*, the jeep was transferred to the corporation *after* it had ran over a child, to evade personal liability under the Revised Penal Code. In the *Razon* case, income *payable by Jai Alai* corporation to a foreigner abroad was made to appear as paid by its stockholder,

to evade *Jai Alai's* obligation to withhold income tax thereon. The same is true with the *WCC* cases, the statutory employer had already incurred liability under the law. So, also, the *Marvel* case, to evade payments of war profits taxes.

It is noteworthy that if a corporation is used to reduce liability *not yet incurred,* the same will not be pierced under this ground (it may be pierced under the second ground, if it has no substantial, bona fide, real separation in function and activity from the controlling stockholder). Thus, in the *Palacio* case, if the corporation were really and substantially different and independent from its stockholders, a stockholder may transfer to the corporation his jeep in exchange for stocks therein, and the jeep will then be owned by the corporation, so that subsidiary liability for criminal negligence occurring in its operation *thereafter*, will be borne only by the corporation. *Reducing or limiting liability not yet incurred, by legal means, is allowed* (*Koppel* case). This cannot be achieved through a blind or sham corporation, nor through a real corporation dominated by the stockholders as sole or controlling owner. A blind or sham corporation is not countenanced by law (*Liddell case*). A dominated corporation, on the other hand, while it may be legal, will not be a means to reduce liability, because the dominance will result in the two corporations being treated as one for purposes of determining liability (*Yutivo case*). This latter case is piercing the veil under the second class of grounds.

The second ground, as stated, is that the corporation is a mere *alter ego*, business conduit, agency, department, etc.

The *Yutivo* case falls under this class. The Supreme Court therein clearly emphasized that Southern Motors, the wholly-owned subsidiary of Yutivo, was not organized nor operated for a fraudulent or unlawful purpose. It had a valid business purpose—to *retail* cars. Yet, because in actual operation, it did not function as a separate entity but as a mere branch of Yutivo, it was deemed one and the same as the latter. So, to determine Yutivo's liability for the sales tax in question, Southern Motors' sales were deemed those of Yutivo.

The facts warranting a finding of a subsidiary's being a mere *alter ego* of its parent, are of two kinds: (1) interlacing of activities; and (2) domination of activities.

First: If the parent and subsidiary corporations' or the stockholders' and the corporation's activities are so *commingled and interlaced* as to be indistinguishable, then the corporate fiction is set aside for purposes of determining the consequence of their activities. So, payment of each other's accounts, including salaries of personnel (*Yutivo, Norton* cases); commingling of funds (*Yutivo; McConnel*); interchangeability of personnel (*La Campana; Norton*); common offices or place of

establishment (*Norton; La Campana; McConnel*) were deemed tell-tale marks of identity of two corporations *with common ownership.*

Second: If the wholly-owned corporation is so dominated by its stockholder-owner as to have no substantial existence or operation of its own, it is also deemed a mere *alter ego* of the said owner, whether a natural person or another corporation. Examples of a natural person who dominated a corporation he totally owned and thus was regarded as one and the same as the corporation, are the *Willets, University of the Visayas, Villa Rey and Ramirez cases.* Examples of a corporation-owner of another corporation, dominating the other through its control usually based on such ownership: *Koppel, Yutivo and Norton* cases.

Several criteria exist for determining the presence of such dominance. Full ownership *alone* is not enough. In light of the decisions, however, it is almost unavoidable that with full ownership the other necessary elements of dominance will follow. In *Koppel,* the Supreme Court confessed it is hardly conceivable how a corporation owned 99.5% by another could avoid being so dominated by its corporate owner, and that full power over *selection* of the board usually means also full power over *action* of the board.

Nonetheless, in theory, ownership is not enough. It must be coupled with dominating control of the activities of the subsidiary by the owner corporation.

Such dominance can be gleaned from financing of activities (*Norton*); departure from regular course of business, such as allowing other party to solely determine one's share in the profits (*Koppel*); interlocking directorate, common offices, or same management (*Yutivo; Norton; La Campana*); liberty to dispose of funds deposited in bank for payment of private debts (*Ramirez*).

Note that in the above cases, there is present ownership, total or nearly total, of the dominated corporation. Suppose a corporation is dominated yet not substantially owned? Such a case is difficult to imagine, unless there is a voting trust. Since a trustee represents here many owners, the second ground for piercing will not obtain. Also noteworthy is that in the cases where the Supreme Court refused to pierce the veil, the reasons were: (a) In the *Araneta* case, because piercing the veil there would not promote justice but injustice; (b) In the *Tantongco* case, because again piercing the veil there would merely promote evasion of execution of judgment; and (c) In the *Behn Meyer* case, because notwithstanding common management and interlocking directorate, the subsidiary had substantial existence and

operation of its own, perhaps because it was not totally or nearly-totally owned by the parent corporation.

The *Behn Meyer* case is the only Philippine case where the Supreme Court recognized the separate existence of a subsidiary in the face of it being challenged on the ground of some factors of identity. It was not shown, however, to what extent this subsidiary was owned. In fact, there was no real showing that it was substantially owned by the "parent" corporation at all. At any rate, despite interlocking directors and common managers, the subsidiary clearly had substantial amount of distinct operations. In the cases of *Koppel* and *Liddell,* the subsidiaries dealt business with no other entities.

The situation of *Liddell* is rather an extreme kind of *alter ego,* that of a *mere shell, sham, blind or dummy.* It is also the same as *Marvel* corporation. Such corporations did not even have any business purpose at all. In the *Yutivo* case, Southern Motors had a business purpose, only, said business purpose was pursued under domination by Yutivo. In *Liddell,* Liddell Motors was just a front, a pure dummy, as indicated by the fact that the vehicles sold to it by Liddell & Co., were sold to the public *on the same day,* touching the hands of Liddell Motors only by pure formality. So, also, *Marvel* corporation was a mere shell—it had no meetings. It was only a blind to evade taxes. In both *Liddell* and *Marvel,* the *blind, dummy, shell* or *sham* corporation was further used to evade taxes or for unlawful purposes. They are however classified under the second ground because in the first ground, we presuppose a real corporation—with valid business purposes—which is in a given case *used* to further a *wrongdoing.*

IV. RESUME

The separate corporate entity is a fiction of law designed to serve the purposes of justice and convenience.

If, therefore, it is used to commit fraud, injustice, wrongdoing or illegal act, it will be disregarded. This presents no difficulty in analysis.

The difficulty is in other cases, involving full ownership of a corporation by one person, one family or one corporation.

The Philippine Supreme Court's decisions on this are that mere ownership of a corporation by one person, natural or juridical, does not by itself alone or *per se* warrant disregard of the fiction. But, if the owned corporation is so *controlled* by the owner as to be its mere agency, conduit or *alter ego,* or their activities are fused, mingled and interlaced, the courts will treat them as one, even if there is no illegal usage of the corporate form.

Is it possible to avoid such domination of a corporation one fully owns? The Supreme Court itself said it is difficult to conceive how it can be done in practice. The principle, however, remains, that if one merely owns a corporation but uses one's ownership for the purpose of participating in the affairs of the corporation in the usual manner, not to substitute one's decision and action for that of the corporation or its board, giving the subsidiary real and substantial independence, letting it do business with others, respecting and maintaining its separation in management, place of business, funds, assets, policies, personnel, etc., then the corporate fiction will not be pierced on the *alter ego ground*. In short, *such full or nearly full ownership must be held solely for investment, not for purposes of control.*

And so who shall control the subsidiary? The directors thereof, distinct from the directors of the owner corporation. Is this not indirect control by the stockholder-owner, as its nearly total voting power gives it absolute control in choosing directors? Not necessarily, because the stockholder- owner can stop further participation in running the corporation *after* it selects the board. In practice, this may prove too much to ask of a full or nearly total owner. Yet if it is remembered that this is the price of separate corporate existence of a wholly-owned subsidiary, it may not be too undemandable a sacrifice. For the opposite effect, piercing the veil, may be more costly to the owner. It is really a matter of policy choice or consideration. If the owner deems it more profitable to operate the subsidiary as a mere branch even if its corporate existence will probably be pierced, then let him risk its being pierced. But if he deems it better to preserve the separate existence of the subsidiary, then he must forfeit his power to control it, by selecting a board of directors and giving them substantial independence, dealing with said subsidiary as if it were another corporation, with no special arrangements departing from the ordinary and regular course of business.

This does not go against the concept of the corporation as a medium for limiting or avoiding personal liability. For we are here dealing with corporations owned and controlled by *one person only*. And the rule is: A person cannot limit his liability by forming a corporation wholly-owned and dominated by him. The same rule applies to a corporation owning substantially another corporation. However, the concept of the corporation demands a joint enterprise by more than one person, natural or juridical. More than one corporation may own in substantial portions another corporation. The problem of *alter ego* will not likely arise there any more than where more than one natural person hold substantial portions of one corporation. But for one person or one corporation to be the sole owner of a corporation, the dangers of the latter's being reduced to a mere *alter ego* are formidable.

There may however obtain reasons due to sound business considerations rendering it advisable for the owner to hold ownership solely for investment and place control in the hands of non-owners (except for nominal shares) without reducing them into his dummies or agents, but allowing them to run the business on their own but practically in trust for him. In such cases, the temptation to dominate will be lesser, because sound business judgment had decided against it.

And in such a case, how precisely will the set-up be? We can only state that in principle, the corporate or individual sole owner must not take part in the decision-making of the corporation except to choose directors, say annually. Another way is to avoid *all* the factors considered by the Supreme Court as circumstances warranting piercing the veil of corporate fiction if possible, or at least minimize them to the utmost. Since there is no assurance that new factors will not be added to this growing list, the avoidance of the recognized instances is not a fail-safe solution. It is, however, our best guide to predicting the pattern of future Supreme Court rulings in view of the principle they illustrate.