REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

HOSPICIO DE SAN JOSE,
Petitioner,

- versus - C.T.A. CASE NO. 4224

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

2/28/91

D E C I S I O N

This case involves the review of respondent's decision assessing petitioner Hospicio de San Jose for deficiency income tax in the amount of P343,087.17 for the year 1980.

The facts are not in dispute, the issue here being purely a question of law. As gleaned from the record, petitioner is a non-stock, non-profit, charitable organization duly registered with the Securities and Exchange Commission. As such, petitioner falls within the purview of an exempt organization under Section 27(e) [now 26(e)] of the National Internal Revenue Code.

Petitioner's income consisting of donations and miscellaneous contributions are exempt from income tax while the income derived from its real and personal properties, such as rentals, interests and dividends are subject to income tax pursuant to the provisions of Section 27 (now 26) of the Tax Code.

The 1980 Income Tax Return filed by petitioner reflected a net loss of P29,988.88 on its taxable operation due to the offsetting of the loss incurred in its non-taxable operation against the income from the taxable operation. (pp.48 & 52, BIR records)

Upon investigation of petitioner's internal revenue tax liabilities for 1980, respondent disallowed as a deduction from petitioner's taxable income, the amount of P671,215.97 representing the said loss incurred by petitioner from its charitable and educational operations.

As a consequence, in a letter dated April 7, 1986, respondent assessed petitioner for deficiency income tax in the amount of P343,087.17 for the year 1980, as follows: (Annex A, p.3, CTA records)

Deficiency Income Tax - 1980

Net taxable income.....	P641,227.09
Income tax due.........	P214,429.48
Add: 20% int. fr. 4/16/81 to 4/16/84............	128,657.69
TOTAL AMOUNT DUE AND COLLECTIBLE...........	P343,087.17

On April 25, 1986, petitioner protested the assessment, which protest was denied by respondent in a letter dated October 20, 1987.

Hence the present recourse. The parties submitted the case for decision based on the pleadings sans memoranda.

The sole issue for resolution is whether or not the loss incurred by petitioner in its tax-exempt operation may be deducted from the income of its taxable operation.

Petitioner contends that the loss from its tax-exempt operation is deductible from its taxable gross income by virtue of Section 30(d)(2) of the National Internal Revenue Code which provides that a corporation may deduct from gross income "all losses actually sustained and charged off within the taxable year and not compensated for by insurance or otherwise".

With this, We are unable to agree.

As a non-stock, non-profit charitable organization, petitioner's tax exemption is governed by Section 27 (now Section 26) of the National Internal Revenue Code, the pertinent provisions of which follow:

> *Section 27. Exemptions from tax on corporations- The following organizations shall not be taxed under this Title in respect to income received by them as such-*
>
> *xxx xxx xxx*

> *(e) Corporation or association organized and operated exclusively for religious, charitable, scientific, athletic, or cultural purposes, or for the rehabilitation of veterans no part of the net income of which inures to the benefit of any private stockholder or individual.*
>
> *xxx xxx xxx*
>
> *Notwithstanding the provisions in the preceding paragraphs, the income of whatever kind and character of the foregoing organizations from any of their properties, real or personal, or from any of their activities conducted for profit, regardless of the disposition made of such income, shall be subject to the tax imposed under this Code. (As amended by PD 1457)*

In the National Internal Revenue Code enacted by Commonwealth Act No. 466 and approved on June 15, 1939, the abovequoted last proviso as attached to Section 27(e) then read:

> *Provided, however, that income of whatever kind and character from any of its properties, real or personal, except income expressly exempted by this Law, shall be liable to the tax imposed under this Chapter.*

This provision was amended in 1946 by Republic Act No. 82. The opinion of the then Secretary of Justice as to the significance of such amendment, as published in BIR G.C. No. V-287 dated April 7, 1959 is quoted hereunder:

> *The first relevant amendment is the addition of the phrase, 'regardless of the disposition made of such income.' It is evident that this was intended to*

> *clarify the purpose of the proviso, which is to place beyond the purview of the exemption income from real and personal properties even if the same was used for religious or other exempt purposes. By this amendment destination of such income is no longer the test of the exemption. As expressed in the explanatory note of the amendatory bill, the prevailing sentiment was that an exempt organization which derives income from rentals or investments of its properties should be made to pay the income tax in the same manner as other corporations or individuals. (Underlining Ours)*
>
> *Another significant change in the proviso is the insertion of the phrase 'or from any activity conducted for profit,' which restricts further the exemption by excluding therefrom income from any business venture or activity of the exempt organization.*
>
> *xxx xxx xxx*
>
> *"Considering the history of the provision in question, it would seem that the statute as now amended has restricted the tax exemption of religious, educational and other organization therein specified only to the extent of withdrawing the exemption with respect to income realized (a) from the productive use of their real and personal properties - e.g., rents dividends, or interest - and (b) from profitable business pursuits, which properties or businesses are not essential to, or necessarily connected with, their religious, charitable, or educational purposes, etc., as the case may be." (Opinion No. 45, Series of 1959)*

It is clear from the foregoing interpretation that the legislative intent in amending the proviso in Section 27 by the insertion of the phrase "regardless of the disposition made of such income" *is to tax the income from real and personal properties or from any activity conducted for profit of exempt organizations even if used for religious, charitable or other exempt purpose. In other words, the taxable income of such organizations should be treated as separate and distinct from their tax-exempt income for purposes of taxation. In which case, the deficit incurred in the tax-exempt operations cannot be set off against the income from taxable operations. The subsequent deletion of the subject provision from subsection(e) of Section 27 by Presidential Decree No. 1457 which took effect on June 11, 1978 and the transposition of the same as the last paragraph of the same Section to cover all exempt organizations under that Section, lends support to our conclusion. Conformably, the loss suffered by petitioner from its fully exempt operation cannot be allowed as a deduction from its taxable income.*

Petitioner insists that respondent's predecessor had already ruled more than twenty years before that in reporting net income, such operating losses may be deducted from its taxable income, to wit: (p. 74, BIR records)

December 15, 1966

Padilla Law Office
6th floor, Shurdut Bldg.
Muralla, Manila

Attn: Atty. Sabino Padilla Jr.

Gentlemen:

In reply to your letter dated September 23, 1965 regarding the proposed assessment for deficiency income tax against our client, the Colegio del Hospicio de San Jose, for the years 1957 to 1961 inclusive, in the amount of P83,108.00, and your letter dated November 16, 1966 regarding a similar assessment against the same taxpayer, for the year 1963 in the amount of P27,479.76, I have the honor to inform you that , after a careful study of the facts and the law on the subject, this Office has decided and hereby holds that in reporting net income, any deficit in the exempt income of said taxpayer, incurred in its exempt operations as an educational and charitable institution, may be deducted from its taxable income in the form of rents, dividends and interest.

This Office has found also that the Colegio del Hospicio de San Jose was incorporated on June 11, 1917 exclusively for educational and charitable purposes, such as the instruction and education of boys and girls and the maintenance of resident students and pupils; that the Hospicio provides a home for the aged and abandoned children; that it is financed and maintained by means of the tuition fees, donations, charitable contributions and income from its real and personal properties such as rentals and dividends. Since said taxpayer is a private educational institution, its net income, computed in the manner above described, is subject to income tax at the rate of 10% provided for in Section 24 of the Tax Code.

> For the year 1963, the amount of P4,939.40 of general expenses has been disallowed, after investigation. However, after adding this amount to the net income per return of the taxpayer of P8,916,31, the income tax due thereon, at the rate of 10%, came to only P1,386.00, which is less than the amount of P1,962.00 actually paid by the taxpayer for that year.
>
> In view of the foregoing, this Office has finally decided not to push through our proposed assessment for the years 1957 to 1961 inclusive, and for the year 1963 and these cases, insofar as this Office is concerned, are hereby considered closed and terminated.
>
> Very truly yours,
>
> (SGD) AMBROSIO M. LINA
> Acting Deputy Commissioner
> of Internal Revenue

Thus, it is petitioner's position that even if respondent were to reverse the abovestated ruling, such revocation can only be applied prospectively, pursuant to Section 327 (formerly Section 338-A now Section 246) of the Tax Code which states:

> Sec. 327. Non-retroactivity of rulings.- Any revocation, modification, or reversal of any of the rules and regulations promulgated in accordance with the preceding section or any of the rulings or circulars promulgated by the Commissioner shall not be given retroactive application if the revocation, modification, or reversal will be prejudicial to the taxpayers except in the following cases: (a) where the taxpayer deliberately misstates or omits material facts from his return or in any document required of him by the Bureau of

> *Internal Revenue; (b) where the facts subsequently gathered by the Bureau of Internal Revenue are materially different from the facts on which the ruling is based; or (c) where the taxpayer acted in bad faith.*

It is averred by respondent, however, that although said ruling on December 15, 1966 was issued in petitioner's favor, BIR Ruling No. 638 dated December 29, 1959 and BIR Ruling dated March 28, 1973 interpreted the proviso in Section 27 of the Tax Code to mean that any deficit incurred by a tax-exempt entity under Section 27 in its exempt operations, may not be deducted from its taxable income in the form of rents, dividends and interests. Furthermore, in the case of ***Hospital de San Juan de Dios, Inc. vs. Commissioner of Internal Revenue****, C.T.A. Case No. 1693, August 29, 1969, the Court of Tax Appeals ruled that the income of a tax-exempt entity from taxable operations i.e. interests and dividends cannot participate in the allocation of administrative expenses incurred in tax-exempt operations. Accordingly, the ruling of December 15, 1966 has been considered revoked by the aforementioned rulings and the above court decision, hence, the said ruling may no longer be applied in the instant case. (Annex C, p.7, CTA records)*

BIR ruling No. 638 dated December 29, 1959 is quoted below:

BIR RULING NO, 638
SERIES OF 1959

December 29, 1959

Sycip, Gorres, Velayo & Co.
Certified Public Accountants
490 San Luis, Manila

Gentlemen:

With reference to your letter dated December 21, 1959, I have the honor to inform you as follows:

In our ruling dated August 5, 1959, we allowed, in computing the income tax payable by a corporation engaged in both taxable and tax-exempt industries, the consolidation of the net income of the taxpayer from its taxable, partly taxable, and fully exempt operations, From the total consolidated net income, the fully exempt income is deducted. On the remainder, the corporate tax is computed as if it is fully taxable. The amount of tax on the partly taxable income or the fully taxable income shall then consist of that portion of the corporate tax thus arrived at which bears the same ratio to such tax as such income bears to the taxable consolidated net income.

In your instant query, however you presented a situation where the fully exempt and taxable operations suffered losses. You now posed the question of whether or not the losses derived from the fully exempt and taxable operations are deductible from the net taxable income.

> In reply thereto, I have the honor to inform you that the computation allowed in our letter of August 5, 1959 stands. But the loss derived from the fully exempt operation cannot be deducted from the taxable net income. However, any loss incurred in the partly and fully taxable operations may be deducted from such taxable net income. (Underlining Ours)
>
> Very truly yours,
>
> (SGD) MELECIO R. DOMINGO
> Commissioner of Internal Revenue

Although it is true that the abovequoted ruling of December 29,1959 shows the reverse of respondent's stand in his ruling of December 15, 1966, still the former, having been issued much earlier, could not have revoked the latter ruling to petitioner. As to the other BIR ruling dated March 28, 1973 reiterating the ruling in BIR Ruling No. 638, such cannot be accorded any weight as it appears to be a mere opinion rendered on a mere query to another taxpayer and besides being unnumbered there is no showing that it has been widely circulated or published.

The case of **Hospital de San Juan de Dios, Inc., vs. Commissioner of Internal Revenue**, C.T.A. Case No. 1693, August 29,1969 (Affirmed in G.R. No. L-31305, May 10, 1990), relied on by respondent, is not in point. There, the issue of whether the *interest and dividend income of the taxpayer under Section 27(e) of the NIRC should share in the allocation of administrative expenses, was settled in the negative by the Supreme Court as follows:*

> *The Court of Tax Appeals found that the interest and dividends received by the petitioner "were merely incidental income to petitioner's main activity, which is the operation of its hospital and nursing schools [hence] the conclusion is inevitable that petitioner's activities never went beyond that of a passive investor, which under existing jurisprudence do not come within the purview of carrying on any 'trade or business.'" (pp. 47-48, Rollo.) That factual finding is binding on this Court.*
>
> *And, as the principle of allocating expenses is grounded on the premise that the taxable income was derived from carrying on a trade or business, as distinguished from mere receipt of interest and dividends from one's investments, the Court of Tax Appeals correctly ruled that said income should not share in the allocation of administrative expenses (p. 49, Rollo).* *(Underlining Ours)*

It will be noted that in resolving the issue in the abovecited case, the provision dealing with the deductibility of business expenses under Section 30 of the Tax Code was applied. Here in the case at bar the relevant provision is not Section 30 but Section 27 of the Tax Code. It is apparent that the rulings and decision cited by respondent did not revoke the ruling to petitioner *of December 16, 1966 prior to the issuance of the deficiency income tax assessment.*

*Nevertheless, We do not find said assessment to be a retroactive revocation of the ruling, hence Section 327 (formerly Section 338-A now Section 246) of the National Internal Revenue Code is inapplicable. Well-established is the rule that the government is never estopped from collecting taxes because of mistakes or errors on the part of its agents, in line with the doctrine laid down in the case of **Hilado vs. Collector of Internal Revenue**, 100 Phil. 288 (1956), as follows:*

> *"With regard to the contention that General Circular No. V-139 cannot be given retroactive effect because that would affect and obliterate the vested right acquired by petitioner under the previous circular, suffice it to say that General Circular No. V-123, having been issued on a wrong construction of the law, cannot give rise to a vested right that can be invoked by a taxpayer. The reason is obvious: a vested right cannot spring from a wrong interpretation. This is too clear to require elaboration.*
>
> *"It seems too clear for serious argument that an administrative officer can not change a law enacted by Congress. A regulation that is merely an interpretation of the statute when once determined to have been erroneous becomes nullity. An erroneous construction of the law by the Treasury Department or the collector of internal revenue does not preclude or estop the government from collecting a tax which is legally due"*

As We have determined earlier, the deduction from taxable income of the losses incurred by petitioner in its exempt operation is not in accordance with law. Since the December 15, 1966 ruling issued to petitioner by respondent's predecessor is an erroneous interpretation of the law and therefore a nullity which could not give rise to a vested right that can be invoked by petitioner, the government is not precluded from collecting such tax which is legally due it.

An adherence to this well-settled principle in the ***Hilado case*** *was emphasized not long ago by the Supreme Court in the case of* ***Zapata Marine Services, Ltd., S.A. vs. Court of Tax Appeals et. al.****, G.R. No. 80046, April 18, 1988, where the applicability of Section 327 on non-retroactivity of rulings was in issue, when it ruled:*

> *Considering also that the construction of a statute by those administering it is not binding on their successors if thereafter, as in this case, the latter become satisfied that a different construction should be given, presumably because the facts subsequently gathered by them are materially different from the facts on which the previous construction is based, the ruling of the then Commissioner Plana adverted to by petitioner may be revoked by respondent Commissioner and the revocation may be applied retroactively without causing prejudice to petitioner since petitioner acquired no vested right from said ruling as it arose from a wrong interpretation of the law.*

Assuming for the sake of argument that there is such a retroactive revocation, petitioner has failed, however, to prove that injustice would result to it therefrom. Under Section 327, rulings or circulars promulgated by the Commissioner of Internal Revenue would have no retroactive application if to so apply them would be prejudicial to taxpayer. In the present case, no such prejudice was shown. On the contrary, petitioner had profited from the ruling of December 15, 1966 for as revealed by the record, petitioner did not pay income taxes on its taxable income for the years 1978 and 1979 due to its having deducted therefrom, the losses incurred in its exempt operation, pursuant to the aforestated ruling issued to it. (See pp. 6 & 8; 28 & 32, BIR records)

*For all the foregoing, We hold petitioner liable for deficiency income tax for the year 1980. However, in our opinion the additional requirement of 20% interest in the sum of P128,657.69 imposed by respondent should be eliminated because the petitioner relied in good faith upon the ruling rendered by no less than a Deputy Commissioner of the Bureau of Internal Revenue. [**ABS-CBN Broadcasting Corporation vs. Court of Tax Appeals***

and the Commissioner of Internal Revenue, *108 SCRA 142 (1981);* ***Tuason, Jr. vs. Lingad,*** *58 SCRA 170 (1974);* ***Connel Bros. Co. (Phil.) vs. Collector of Internal Revenue,*** *10 SCRA 470 (1964)].*

As regards the tax refund claimed by petitioner in the sum of P44,805.25, representing income tax withheld at source for the years 1979 and 1980, no evidence whatsoever was presented in support thereof, thus, it has to be denied.

Accordingly, petitioner Hospicio de San Jose, is hereby ordered to pay to respondent Commissioner of Internal Revenue the amount of P214,429.48 as deficiency income tax for the year 1980.

WHEREFORE, *the* ***decision appealed from is modified as indicated in the above opinion of the Court. With costs.***

SO ORDERED.

Quezon City Metro Manila, February 28, 1991.

ALEX Z. REYES
Presiding Judge

I CONCUR:

CONSTANTE C. ROAQUIN
Associate Judge

C E R T I F I C A T I O N

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

ALEX Z. REYES
Presiding Judge
Court of Tax Appeals