REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

ST. PAUL'S HOSPITAL OF ILOILO,
Appellant,

- versus - C.T.A. CASE NO. 6

COLLECTOR OF INTERNAL REVENUE,
Appellee.

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D E C I S I O N

This is an appeal originally filed with this Court, taken by the appellant, St. Paul's Hospital of Iloilo, from a decision of the appellee, Collector of Internal Revenue, demanding the payment of the amount of ₱16,506.25, allegedly representing income tax assessments of the hospital for the years, 1947, 1948, 1949, 1950, 1951 and 1952, including penalties, interests and surcharges. After the issues were joined with the filing of the appellee's answer, the case was set for hearing for the reception of evidence, but as the trial progressed, the attorneys for both parties included the income tax assessment for 1953 in the amount of ₱50.00 as compromise for violation of bookkeeping regulations, the hospital having suffered a loss in the said year. To the end that all matters in dispute between the parties may, as far as possible, be completely determined in a single proceeding, the income tax assessment for 1953 is therefore included in this decision, although the pleadings were not amended.

It appears that sometime in September, 1941, a group of Sisters of the St. Paul's de Chartres agreed to organize among themselves a non-stock corporation for the purpose of operating a hospital that would provide medical assistance to destitute persons. The corporation was also formed to instruct and train suitable persons in the duties of nursing and to provide the instructions and consolations of religion for those who are under the care of the institution. The name of the corporation as registered in the Securities & Exchange Commission is St. Paul's Hospital of Iloilo, but as early as 1911, the then Bishop of Jaro, Iloilo, of the Roman Catholic Church, had already founded the St. Paul's Hospital of Iloilo in the Municipality of Iloilo for charitable, educational and religious purposes and entrusted its management to some four members of the Sisters of St. Paul's de Chartres. The hospital at first had its humble beginnings, but as years passed, it continued to improve and expand its buildings, equipment and facilities, as well as its school of nursing.

Since its foundation and up to the present time, the St. Paul's Hospital of Iloilo has always been dedicated to charitable, educational and religious purposes (with the exception of the loans granted to private individuals in 1951, 1952 and 1953) and no part of its net income inures to the benefit of any private person or individual. All of its income, which consists mostly of hospital fees and costs of medicine from pay patients, as well as tuition fees from its student-nurses, are used exclusively for the operation, management, improvement and expansion of the institution, and for the attainment of its charitable, educational and religious activities. It extends all necessary and adequate medical, surgical and nursing services, aid and care to anybody who may need them, irrespective of whether they can afford to pay or not. It even gives alms once a week to the poor and, in case of need, provides funeral expenses to the destitute who die under its care. Roman Catholic tenets are taught and inculcated in the minds of its student-nurses, as well as the personnel of the hospital and patients who would like to embrace the religion. In fact, the institution maintains a chapel where Roman Catholic religious ceremonies are held.

The St. Paul's Hospital of Iloilo is managed and operated by some fifty Sisters of St. Paul's de Chartres under the supervision and direction of a Mother Superior, appointed by the Board of Trustees of the corporation. These Sisters work for the corporation without salary because it appears that they are prohibited by the rules and regulations of their religious society to own property. However, the management of the hospital annually sets aside the sum of ₱72,000.00 for the expenses of these Sisters, although this amount is not directly given to them. It is spent for them by the Mother Superior for their clothings, personal necessities, religious equipments, traveling expenses when required to attend religious exercises in Manila, maintenance of their chapel, including the salaries of chaplains, and alms which they give to the poor and needy.

Under the foregoing set of facts, the only question to be resolved in this case is whether or not the net income derived by the appellant as a charitable, educational and religious institution is subject to income tax under the provisions of Section 24 of the National Internal Revenue Code, notwithstanding the provisions of Section 27(e), as amended by Republic Act No. 82. A similar question involving analogous set of facts was raised and decided on October 7, 1954 by this Court in B.T.A. Case No. 190, entitled "Convention of Philippine Baptist Churches vs. Collector of Internal Revenue". This Court, in the light of the decision of the Supreme Court in the case of "Jesus Sacred Heart College vs. Collector of Internal Revenue", G.R. No. L-6807, promulgated on May 24, 1954, answered the query in the negative. The Supreme Court ruled in Sacred Heart College case that the plaintiff is exempt from taxation under the first part of said paragraph (e). Due to its decisive effects on the case at bar, we will again quote hereunder the controlling portions of the decision:

> "Section 27 (e) of the National Internal Revenue Code, as amended by Republic Act No. 82 (Section 5), exempts from taxation the '<u>net income</u>' of corporations 'organized and operated exclusively for x x x educational purposes x x x no part of the net income of which inures to the benefit of any private stockholder or individual,' and it is conceded that plaintiff corporation belongs to this class. To hold that an educational institution is subject to income tax whenever it is so administered as to reasonably assure that it will not incur in deficit, is to nullify and defeat the afore-mentioned exemption. Indeed, the effect, in general, of the interpretation advocated by appellant would be to deny the exemption whenever there is a net income, contrary to the tenor of said section 27(e) which positively exempts from taxation those corporations or associations which, otherwise, would be subject thereto, because of the existence of said net income.
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> "More important still, the law applied in the cases relied upon by appellant exempted from taxation only such educational institutions as were established for <u>charitable</u> or <u>philantrophic</u> purposes.

> Consequently, the amount of fees charged or the intent to collect more than the cost of operation or instruction was material to the determination of such purpose. Upon the other hand, under section 27(e) of our National Internal Revenue Code, as amended, an institution operated exclusively for educational purposes need not have, in addition thereto, a charitable or philantrophic character, to be exempt from taxation, provided only that no part of its net income 'inures to the benefit of any private stockholder or individual'.
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> "Lastly, the history of the legal provision under consideration does not bear out the theory of appellant herein."

The charitable, educational and religious purposes of the St. Paul's Hospital of Iloilo having been duly shown, operating as such for the public, we therefore hold that the net income derived by it under these conditions is exempt from income tax under the provisions of the first part of Section 27(e) of the National Internal Revenue Code, as amended by Republic Act No. 82. However, the evidence for the Government shows that the appellant has lent some of its surplus funds to the Cookum Sons Hardware, Uy Sieng & Huang Sun Nan and Manuel Asencio in 1951 and to Go Julian in 1953 and that it has been collecting interest on these loans ranging from 8% to 12% per annum. The Mother Superior testified that the hospital has never engaged in the business of lending its funds, but these isolated transactions were only due to the persistent supplication of the lawyer of the corporation who had promised financial help to his clients then in financial difficulties. And the interest collected by the corporation in the amounts of ₱2,800.00 in 1951, ₱5,600.00 in 1952 and ₱6,100.00 in 1953 was only in grateful appreciation for the financial assistance extended to the foregoing persons in the form of a loan. This testimony was collaborated by the attorney of appellant corporation who took the witness stand to explain these transactions.

Under the second part of subsection (e), Section 27 of the National Internal Revenue Code, as amended, we hold and rule that the interest collected on these loans is clearly an income derived "from any activity conducted for profit" and hence excluded from the exemption provided for in the first part thereof. The Supreme Court, in explaining the changes introduced by Republic Act No. 82, stated in part in the case of the Sacred Heart College that said amendment clarified the meaning of the proviso, by declaring that the income therein mentioned shall be taxable "regardless of the disposition made of such income" and that in the proviso there is an additional limitation to the exemption established in the first part of paragraph (e), by excluding from said exemption the income of the aforementioned corporations or associations derived "from any activity conducted for profit." (Jesus Sacred Heart College v. Collector of Internal Revenue, supra). We believe that under this amendment, the destination of the income is not the test of exemption. And it is but fair and just that the appellant which derives income in the form of interests from investments of its funds should pay the income tax in the same way as other individuals or corporations, for the government affords also protection to its properties. Consequently, there is due from the St. Paul's Hospital of Iloilo the amount of ₱3,685.00, computed as follows:

Year			Interest Earned From Loans
1951			₱2,800.00
	20% tax on ₱2,800.00	₱ 560.00	
	25% surcharge	140.00	
	Compromise for late filing	20.00	
	Total tax & penalties	₱ 720.00	
1952			₱5,600.00
	20% tax on ₱5,600.00	₱1,120.00	
	25% surcharge	280.00	
	Compromise for late filing	20.00	
	Total tax & penalties	₱1,420.00	
1953			₱6,100.00
	20% tax on ₱6,100.00	₱1,220.00	
	25% surcharge	305.00	
	Compromise for late filing	20.00	
	Total tax & penalties	₱1,545.00	
TOTAL of all taxes and penalties		₱3,685.00	

Without in anyway expressing an opinion as to the liability of the appellant for the payment of income taxes in case its money lending transactions should be carried on in a business scale, it will be observed that under the part first of sub-section 27(e), the corporation or association to be entitled to exemption from income taxation must be organized and operated exclusively for one or more of the specified purposes mentioned therein and no part of its net income inures to the benefit of private stockholders or individuals.

"Meaning of the term 'organized and operated exclusively' for religious purposes. - The term 'organized,' as used in Section 27(e) refers to the real substance and intent of the organization and not to its mere form. The charter and by-laws of the organization are merely evidence of its purposes which may be supported or rebutted by extraneous evidence. The court held that the true purpose of the corporation's organization could be

> shown by evidence aliunde the charter. It is immaterial that a corporation is organized under state statutes providing for the formation of benevolent, charitable and educational corporations and the like. It is not the statutory sanction which is material, but the actual purposes and functions of the corporation. The fact that a corporation may engage in business does not mean that it will. The question is one of fact in each case. To be exempt, the corporation must be both organized and operated for charitable or the other permitted purposes." (Formilleza, Commentaries on the National Internal Revenue Code, Vol. I, pp. 100-101, quoting Mertens, Law of Federal Income Taxation, Sec. 34.17).

And the fact that all the income of the organization are dedicated to its operation, maintenance, improvement and expansion, will not in any way change the picture because, as stated above, under the new amendment, the destination of the income is no longer the ultimate test of exemption. This can readily be gleaned from the phrase "regardless of the disposition made of such income."

WHEREFORE, in so far as its charitable, educational and religious purposes are concerned, the St. Paul's Hospital of Iloilo is hereby declared exempt from the payment of income taxes for the years 1947, 1948, 1949,1950, 1951, 1952 and 1953, but should pay to the Collector of Internal Revenue the sum of ₱3,685.00, representing income taxes and penalties due on the interest collected on its loans in the years 1951, 1952 and 1953.

SO ORDERED.

Manila, Philippines, December 4, 1954.

MARIANO NABLE
Presiding Judge

I concur:

AUGUSTO M. LUCIANO
Associate Judge

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