REPUBLIC OF THE PHILIPPINES
Court Of Tax Appeals
QUEZON CITY

FORMER SECOND DIVISION

PERPETUAL SUCCOUR HOSPITAL, INC. and THE SISTERS OF ST. PAUL DE CHARTERS,	**C.T.A. CASE NO. 7304**
Petitioners,	Members:
	CASTAÑEDA, JR., Chairperson, UY, and PALANCA-ENRIQUEZ, JJ.
-versus-	
COMMISSIONER OF INTERNAL REVENUE, ***Respondent.***	**Promulgated:** DEC 0 1 2010 3:25 p.m.

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D E C I S I O N

PALANCA-ENRIQUEZ, J.:

Medical, dental, hospital and veterinary services, except those rendered by professionals, are exempt from value-added tax *(Section 109(l), NIRC of 1997, as amended)*. The maintenance and operation of a pharmacy or drugstore by a hospital is a necessary and essential service or facility rendered by any hospital for its patients. Thus, the facility of making drugs and medicines available to in-patients of the hospital, whether for reasons of life-threatening urgency or mere convenience, cannot but be viewed as a hospital service that is covered by the broad and general exemption provided in *Section 109(l) of the NIRC of 1997, as amended,* for "hospital services".

THE CASE

This is a Petition for Review filed by Perpetual Succour Hospital, Inc. and The Sisters of St. Paul de Charters (hereafter "petitioners") praying for the cancellation of the assessment imposing deficiency income tax, expanded withholding tax (EWT) and VAT.

THE PARTIES

Petitioner Perpetual Succour Hospital, Inc. (hereafter "petitioner PSH") is owned by petitioner Sisters of St. Paul De Charters, a religious congregation, with Philippine provincial station in Antipolo City (hereafter petitioner "SPC"). PSH was established for the healing ministry and apostolate to the sick of SPC. Both may be served with orders and other processes of this Court at Gorordo Avenue, Camputhaw, Lahug, Cebu City, and/or through their counsel of record.

On the other hand, respondent is the incumbent and duly designated representative of the Bureau of Internal Revenue (BIR), as

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defined under the NIRC, with office address at the BIR National Office Building, East Avenue, Quezon City.

THE FACTS

On May 16, 1961, petitioner PSH, thru BIR Ruling No. 185, was granted exemption from income tax by then Commissioner Misael P. Vera, owing to its distinct character as a "religious, non-profit, non-stock and charitable institution".

On October 8, 2001, then Regional Director Jaime B. Santiago issued a ruling sustaining petitioner PSH's exemption from income tax for being a religious, non-profit, non-stock and charitable institution.

On November 11, 2003 respondent issued Preliminary Assessment Notice assessing petitioner PSH of deficiency income tax in the amount of P7,399,457.11, VAT in the amount of P7,609,200.17, and EWT in the amount of P7,512,748.14, or in the total amount of P22,521,405.42, all for taxable year 2001.

On January 26, 2004, petitioners filed their request for reconsideration and/or reinvestigation of the Preliminary Assessment Notice dated November 11, 2003.

On January 22, 2004, His Eminence Ricardo J. Cardinal Vidal, D.D., Archbishop of Cebu, wrote a letter asking for reconsideration from respondent with regard to the PAN issued against petitioner PSH.

Pending resolution thereof, petitioners received impression that LTDO will submit a consulta to the Department of Finance to clarify the effect of the exempt rulings (Vera and 2001) vis-à-vis *Section 27 (B) of the NIRC*. Meanwhile, petitioners submitted a waiver of the prescriptive period.

On March 11, 2005, petitioners received the Formal Letter of Demand with Details of Discrepancy and Assessment Notices, all dated February 7, 2005, assessing petitioners of deficiency income tax in the amount of P7,573,328.96, VAT in the amount of P9,423,551.72, and expanded withholding tax in the amount of P8,533,851.11, or in the total amount of P25,530,731.79.

On March 17, 2005, petitioners protested the Formal Letter of Demand, dated February 7, 2005 *(Exhibit "BB")*. However, on June 10, 2005 respondent issued the Final Decision on Disputed Assessment denying with finality petitioners' protest on the assessment for deficiency income tax, VAT and expanded withholding tax for calendar year 2001, in the total amount of P25,530,731.79, copy of which was received by petitioners on July 6, 2005.

In his "Answer" filed on September 21, 2005, respondent averred that: petitioner PSH, being a non-profit hospital, is subject to 10% income tax, pursuant to *Section 27 (B) of the NIRC of 1997, as amended*, therefore, it is liable for deficiency income tax in the amount of P7,573,328.96; petitioner PSH is liable of P75,000.00 for non-filing of BIR Form No. 1702Q-Quarterly Income Tax Return for the three taxable quarters; petitioner PSH operates a pharmacy/drug store within its hospital building, but filed "no payment" VAT Returns for taxable year 2001; petitioner violated *Section 4.104-1 of Revenue Regulations No. 7-95* since it failed to apply the allocation formula in determining the input tax attributable to the taxable transactions; audit disclosed that petitioner PSH overstated its input taxes carried over from the third quarter to fourth quarter in the amount of P986,175.32, hence petitioner is liable for deficiency VAT in the amount of P9,423,551.72; verification of the Books of Accounts – General Ledger disclosed that petitioner PSH's interest income in the amount of P13,313,485.11 was not subjected to EWT at the rate of 20%, as required under *Section 27(D)(1) of the NIRC of 1997, as amended;* petitioners failed to withhold 10% expanded withholding tax on its payments to professionals – doctors in the amount of P10,690,953.03; during taxable year 2001, petitioner failed to withhold 2% EWT expanded withholding tax from its payments to its service contractors in the amount of P68,686,128.32; hence petitioner PSH is liable for deficiency withholding taxes in the amount of P8,533,851.11.

By way of special and affirmative defenses, respondent averred that the assessment had already become final, executory and unappealable for petitioner PSH's failure to submit all relevant documents in support of its protest, within sixty days from filing its protest, pursuant to *Section 228 of the NIRC of 1997, as amended*, and *Section 3.1.5 of Revenue Regulations No. 12-99*; and all presumptions are in favor of the correctness of tax assessment.

Petitioners presented Sister Zeta Caridad Rivero, Provincial Superior of petitioner SPC, and former administrator of petitioner PSH; Sister Maria Lirio Gavan, Provincial Treasurer of petitioner SPC and former Department Head of the Business Office of petitioner PSH; Benjamin C. Hortelano, the Court-Commissioned Independent CPA, as witnesses, and documentary evidence, marked as *Exhibits "A"* to *"FF"*, inclusive of their submarkings, which were all admitted by this Court in a Resolution dated August 14, 2008, except for *Exhibits "D-1-a-1" to "D-*

1-l-98", "D-4-b-1" to "D-4-l-1-203", "D-6-b-1" to "D-6-35-468", "D-8", "F-1" to "F-12-990" for petitioner's failure to mark the same.

On the other hand, respondent presented Revenue Officer, Emeteria M. Ang, as witness, and documentary evidence, marked as *Exhibits "1"* and *"9"*, inclusive of their submarkings, which were all admitted by the Court in a Resolution dated May 6, 2009.

Thereafter, both parties were ordered to file their simultaneous memoranda, within thirty (30) days from notice; afterwhich, the case shall be deemed submitted for decision.

Both parties having filed their respective memorandum, the case was deemed submitted for decision on September 17, 2009.

ISSUES

As stipulated upon by the parties, the following are the issues for this Court's consideration:

I

WHETHER OR NOT PETITIONERS REMAIN TO BE "RELIGIOUS, NON-PROFIT, NON-STOCK AND CHARITABLE INSTITUTIONS".

II

WHETHER OR NOT THE RULINGS DECLARING PETITIONERS EXEMPT FROM INCOME TAX REMAIN VALID AND SHOULD BE ACCORDED RESPECT. *[illegible]*

III

WHETHER OR NOT PSH IS A "NON-PROFIT HOSPITAL" UNDER SECTION 27(B) OF THE NIRC OF 1997.

IV

WHETHER OR NOT THE ASSESSED WITHHOLDING TAX DUE FROM PETITIONER IS ACCURATE.

V

WHETHER OR NOT ALL INCOME OF PETITIONER IS SUBJECT TO VAT.

VI

WHETHER OR NOT THE FORMULA USED BY RESPONDENT AND THE MANNER OF COMPUTING VAT WAS ACCURATE.

VII

WHETHER OR NOT THE SUBJECT ASSESSMENTS HAVE BECOME FINAL, EXECUTORY AND UNAPPEALABLE.

Principal Issues

The foregoing issues can be summarized into four principal issues: (1) Whether or not the subject assessments have become final, executory and unappealable; (2) Whether or not petitioner PSH is a religious, non-profit, non-stock charitable institution, under *Section 30(E) of the NIRC, of 1997, as amended;* (3) Whether or not petitioner PSH is liable for deficiency EWT; and (4) Whether or not petitioner PSH is liable for deficiency VAT.

THE COURT'S RULING

The petition is partly meritorious.

First Issue

Whether the Assessments have Become Final, Executory and Demandable

Respondent CIR contends that the assessments for deficiency income tax, EWT and VAT had become final, executory, and demandable for failure of petitioner PSH to submit all relevant documents in support of its administrative protest, within sixty (60) days from filing of the protest.

Respondent's contention is bereft of merit.

Records show that on January 26, 2004, petitioners filed their request for reconsideration and/or reinvestigation of the Preliminary Assessment Notice dated November 11, 2003 *(Exhibit "Y")*. In support of their request for reconsideration and/or reinvestigation, petitioners submitted the following documentary evidence: BIR Ruling No. 185 *(Annex "1" thereof)* and Regional Director Jaime Santiago's Ruling, dated October 8, 2001 *(Annex "2" thereof)*.

In protest to Assessment Notices dated February 7, 2005, together with the Formal Letter of Demand, also dated February 7, 2005; on March 17, 2005, petitioners reiterated their request for reconsideration and/or reinvestigation filed on January 26, 2004 *(Exhibit "BB")*. Attached to said protest letter is the request for reconsideration and/or reinvestigation filed on January 26, 2004.

On the basis of the foregoing, we cannot sustain respondent's contention that petitioners failed to submit relevant supporting documents that would render the assessment final, because when petitioners filed their request for reconsideration and/or reinvestigation, which was merely reiterated in the protest filed on March 17, 2005, petitioners submitted supporting documents, namely, BIR Ruling No. 185 *(Annex "1", Request for Reconsideration and/or Reinvestigation)*, and Regional Director Jaime Santiago's Ruling dated October 8, 2001 *(Annex "2", Request for Reconsideration and/or Reinvestigation).*

In the case of *Commissioner of Internal Revenue vs. First Express Pawnshop Company, Inc., 589 SCRA 275,* ("First Express Pawnshop case"), the Supreme Court ruled that "the term 'relevant supporting documents' should be understood as those documents necessary to support the legal basis in disputing a tax assessment, as determined by the taxpayer. The BIR can only inform the taxpayer to submit additional documents. The BIR cannot demand what type of supporting documents should be submitted. Otherwise, a taxpayer will be at the mercy of the BIR, which may require the production of documents that a taxpayer cannot submit."

Considering that petitioners submitted supporting documents at the time they filed the protest, which petitioners considered necessary to support the legal basis in disputing the assessments, then petitioners have complied with the requirement of submitting documentary evidence prescribed in *Section 228 of the NIRC of 1997, as amended,* pursuant to the *First Express Pawnshop case.* Hence, the assessments for deficiency income tax, EWT and VAT have not become final, executory and demandable.

<u>*Second Issue*</u>

Whether Petitioner PSH is Subject to 10% Tax under Section 27(B) of the NIRC of 1997, as amended, or is Exempt from Income Tax under Section 30(E) of the NIRC of 1997, as amended.

Petitioners contend that petitioner PSH is a religious, non-profit, non-stock charitable institution exempt from income tax, under *Section 30(E) of the NIRC, of 1997, as amended.*

Respondent counters that petitioner PSH is a non-profit hospital, subject to ten percent (10%) tax on its taxable income for the year 2001 under *Section 27(B) of the NIRC of 1997, as amended.*

While *Section 27(B) of the NIRC of 1997, as amended*, subjects non-profit hospitals to preferential rate of ten percent (10%) when their gross income from unrelated trade, business or other activity does not exceed fifty percent (50%) of their total gross income from all sources, *Section 30(E) of the NIRC of 1997, as amended*, however, exempts from income tax the income received by non-stock corporations or associations organized and operated exclusively for religious or charitable purposes, no part of the income or asset of which shall belong to or inure to the benefit of any member, organizer, officer or any specific person.

Hence, to fall within the ambit of *Section 27 (B)*, the hospital must be: (1) non profit; and (2) its gross income from unrelated trade, business or other activity must not exceed 50% of their total gross income from all sources.

On the other hand, in order that a corporation will be exempt from income tax on income received by them as such, under *Section 30*, it must be a (1) non-stock corporation; (2) operated exclusively for religious or charitable purpose; and (3) no part of its net income or asset shall belong to or inure to the benefit of any member, organizer, officer or any specific person.

Hence, on the basis of the foregoing requirements, when a hospital is proprietary, or private, which is not for profit and its gross income from unrelated trade, business or other activity does not exceed 50% of its total gross income from all sources, it is subject to 10% tax rate. On the other hand, when a hospital is non-stock, meaning, its capital stock is not divided into shares, and is not authorized to distribute to the holders of such shares dividends *(Manila International Airport Authority vs. Court of Appeals, 495 SCRA 616),* operated exclusively for religious or charitable purpose, no part of its net income or asset belong to or inure to the benefit of any specific person, then the hospital will fall under the provision of *Section 130(E) of the NIRC of 1997, as amended.*

Petitioner PSH is a Non-Stock Corporation

Records show that petitioner PSH is a non-stock corporation. Petitioner's Articles of Incorporation, adopted on February 25, 1960, and the Amended Articles of Incorporation, adopted on July 20, 1980, state:

> "That we, the undersigned members of a Roman Catholic Congregation of the Sisters of Saint Paul de Charters, all of legal age and residents of the Cities of Manila and Cebu, Philippines, have this day voluntarily

associated ourselves together for the purpose of forming a non-stock corporation under the laws of the Republic of the Philippines" *(BIR Records, pp. 587 and 593)*.

Petitioner PSH is a Non-Profit Corporation, Operated Exclusively for Religious and Charitable Purpose

In the case of *Manila Club Employees Union vs. Manila Club, Inc., 20 SCRA 1171*, the Supreme Court ruled that the word "business" in its plain and ordinary meaning, refers to activities or affairs where profit is the purpose or livelihood is the motive. Hence, when an entity was not organized for that purpose or motive, but for other purposes, such as the promotion of social relations among its members, like the Manila Club, Inc., then it is not organized for profit. The Articles of Incorporation is the best evidence for that.

Petitioner PSH's Articles of Incorporation provide, as follows:

> "Second. – That the purpose for which such corporation is formed are:
>
> (a) To establish, operate and maintain a hospital;
>
> (b) To provide medical and surgical aid and nursing or other care for the sick, infirm, aged, injured, or destitute persons; subject to the condition that purely professional medical or surgical services in connection herewith shall be performed by duly qualified physicians or surgeons who may or may not be connected

with the corporation and who shall be freely and individually contracted by patients;

(c) To instruct and train suitable persons in the duties as nursing and attending upon the sick;

(d) To provide the instructions and consolations of religion for those who are under the care of the institution;

xxx xxx.

Seventh. – That the corporation shall be maintained by whatever amount it may obtain from fees for services rendered and any other money and/or property it may receive by donations or investments."

From the foregoing, it is clear that petitioner PSH is not organized for profit. It has no capital stock divided into shares. Paragraph seven of its Articles of Incorporation provides that it shall be maintained by whatever amount it may obtain from fees for services rendered and any other money and/or property it may receive by donations or investments. Considering that it has no shares of stock, petitioner PSH does not distribute dividends. Clearly, petitioner PSH is not organized for business. It is a non-profit corporation.

Petitioner PSH's charging of fees for services rendered does not detract from its religious and charitable character. In the case of *Herrera vs. The Quezon City Board of Assessment Appeals, 3 SCRA 191*, the

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Supreme Court ruled: "It is well settled, in this connection, that the admission of pay-patients does not detract from the charitable character of a hospital, if all its funds are devoted 'exclusively to the maintenance of the institution' as a 'public charity' (*84 C.J.S., 617; see, also, 51 Am. Jur. 607; Cooley on Taxation, Vol. 2, p. 1562; 144 A.L.R., 1489-1492*). 'In other words, where rendering of charity is its primary object, and the funds derived from payments made by patients able to pay are devoted to the benevolent purposes of the institution, the mere fact that a profit has been made will not deprive the hospital of its benevolent character' (Prairie Du Chien Sanitarium Co. vs. City of Prairie Du Chien, 242 Wis. 262, 7 NW [2d] 832, 144 A.L.R. 1480)". Said ruling was reiterated by the Supreme Court in the case of *Commissioner of Internal Revenue vs. Bishop of the Missionary District of the Philippine Islands of the Protestant Episcopal Church in the U.S.A., 14 SCRA 996.*

As heretofore discussed, petitioner was formed by the Sisters of Saint Paul de Charters, who voluntarily associated themselves to form a non-stock corporation. The purposes of which are (1) to provide medical and surgical aid and nursing or other care for the sick, infirm, aged, injured, or destitute persons; (2) to instruct and train suitable persons in the duties as nursing and attending upon the sick; and (3) to provide the instructions and consolations of religion for those who are under the care of the institution.

On direct examination, petitioners' witness, Sister Maria Lirio Gavan, testified that any income received is devoted and plowed back to charity and no part thereof goes for the personal gain or inures to the benefit of the SPC Congregation or its members *(TSN, April 26, 2006, p. 15)*, and further testified that whatever excess there is in the operation of hospitals, schools or pastoral centers, they are plowed back to charity to subsidize the poor. If ever there is an excess, the amount is reverted back to the hospital in the form of acquisition of equipment because petitioners believe that they have to be at par also with the technological needs of the patients because there are some hospitals which can cater to the needs of the patients. If they will not be at par with them, then they fail on their apostolate of serving the poor because only the rich can avail of those facilities *(TSN, April 26, 2006, pp. 16-17)*.

Despite the opportunity given to cross examine petitioner's witness, counsel for respondent waived his right *(TSN, April 26, 2006, p. 27)*.

Also, on direct examination, petitioners' witness, Sister Zeta Caridad Rivero, testified that for the healing ministry and apostolate to the sick, petitioner SPC has created, established, and run hospitals, such as herein petitioner PSH. That all income derived has been principally devoted for the benevolent purposes of the institutions founded *(Exhibit "FF", TSN, September 4, 2006, p. 12)*.

Counsel for respondent again waived his right to cross-examine the witness, despite the opportunity given *(TSN, September 4, 2006, p. 13)*. Settled is the rule that where a party has had the opportunity to cross-examine an opposing witness, but failed to avail himself of it, he necessarily forfeits the right to cross-examine and the testimony given on direct examination of the witness will be received or allowed to remain in the record *(People vs. Seneres, 99 SCRA 100-101, Savory Luncheonette vs. Lakas Ng Manggagawang Pilipino, 62 SCRA 164-165)*. The testimonies of said petitioners' witnesses were not refuted by the respondent.

It bears stressing that as early as 1961, then CIR Melencio R. Domingo recognized petitioner as a religious, non-profit, non-stock and charitable institution, hence it was exempt from payment of income tax *(Exhibit "V")*.

Said stand of respondent has been consistent even after it was assessed of deficiency taxes in 1997 by then Regional Director Jaime B. Santiago, when the latter cancelled the deficiency assessment for income tax in a Letter dated October 8, 2001, for the same reason that petitioner

PSH is a religious, non-profit, non-stock and charitable institution *(Exhibit "W")*.

On cross-examination, respondent's witness, Emeteria M. Ang, testified that there was no ruling that has been issued by the BIR revoking petitioner PSH's classification as a religious, non-profit, non-stock and charitable institution *(TSN, February 23, 2009, p. 20)*.

In fact, the basis of the assessment for deficiency income tax against petitioner for taxable year 2001 is solely *Section 27(B) of the NIRC of 1997, as amended*, imposing ten percent (10%) tax on the taxable income of proprietary educational institutions and hospitals *(TSN, February 23, 2009, p. 23)*.

No Part of Petitioners' Net Income or Asset shall Belong to or Inure to the Benefit of any Member, Organizer, Officer or Any Specific Person

As testified by petitioners' witness, Sister Maria Lirio Gavan, any income received by petitioner is devoted and plowed back to charity and no part thereof goes for the personal gain or inures to the benefit of the SPC Congregation or its members. Also, on direct examination, Sister Zeta Caridad Rivero testified that no income or part thereof is used for personal gain by any of the SPC members *(Exhibit "FF", TSN, September 4, 2006, p. 12)*.

Likewise, there is no evidence on record that will show that other persons, natural or juridical, other than the beneficiaries of petitioners' charitable activities, have benefited directly or indirectly from petitioners' assets or income.

It must be stressed that tax laws are civil in nature *(Aban, Law of Basic Taxation in the Philippines, Rev. Ed., p. 143).* In civil cases, the party having the burden of proof must establish his case by a preponderance of evidence *(Sec. 1, Rule 133, Rules of Court; Umpoc vs. Mercado, 449 SCRA 238).* "Preponderance of evidence" means that the evidence adduced by one side is, as a whole, superior to or has greater weight than that of the other *(Habagat Grill vs. DMC-Urban Property Developer, Inc., 454 SCRA 664-665).*

Considering that in the instant case, petitioners have sufficiently established by preponderance of evidence that petitioner PSH is a non-stock, non-profit, religious and charitable institution, and that no part of its net income and assets inure directly or indirectly to the benefit of any other person, and considering further that respondent failed to controvert said findings, We uphold respondent's prior findings that petitioner PSH is a religious, non-profit, no-stock charitable institution *(Exhibit "V").*

Since petitioner PSH is a non-stock, non-profit, religious hospital, operated exclusively for charitable purpose, its income derived from operating the hospital is, therefore, exempt from income tax, pursuant to *Section 30 of the NIRC of 1997, as amended.* However, the income of whatever kind and character from any of its properties, real or personal, or from any of its activities conducted for profit, regardless of the disposition made of such income, is subject to tax imposed by the *NIRC of 1997, as amended (Section 30, last par, thereof).*

A perusal of the audited Statement of Income of petitioner PSH for taxable year 2001 *(Exhibit "DD-4")*, as reflected in its Amended Annual Income Tax Returns *(Exhibit "DD")*, shows that the following were received by petitioner, as income from operating the hospital:

REVENUES	**2001**
Routine services	P129,801,131.00
Pharmacy	77,614,566.00
Special hospital services	57,067,954.00
Total Operating Revenues	264,483,651.00
Less: Charity Discounts	8,500,519.00
Net Operating Revenue	255,983,132.00
Less: Operating Expenses	211,204,825.00
Net Income from Operation	**P44,778,307.00**

The above net income from operations are, therefore, exempt from income tax, pursuant to *Section 30 of the NIRC of 1997, as amended.*

As to Petitioner's Other Income in the amount of P20,246,262.00 for Taxable Year 2001

However, as regards the other income of petitioner PSH for the year 2001, records show that it derived P20,246,262.00 income from non-operating activity of the hospital. Pursuant to the concluding paragraph of *Section 30 of the NIRC of 1997, as amended,* we will now determine the taxability of said income of petitioner PSH from non-operating activity.

A further examination of the records shows that P13,313,485.11 of P20,246,262.00 consists of interest income from banks, subject to final withholding tax under *Section 27(D)(1) of the NIRC of 1997, as amended.* Under *Revenue Regulations 17-84*, interest earned on Philippine Currency bank deposits and yield from deposit substitutes subjected to the withholding taxes in accordance with these regulations need not be included in the gross income in computing the depositor's/investor's income tax liability, in accordance with *Section 32 of the NIRC of 1997, as amended (Section 7(a), thereof).* Hence, the amount of P13,313,485.11 is hereby excluded from the computation of ordinary corporate income tax imposed by the last paragraph of *Section 130 of the NIRC of 1997, as amended.*

However, as to the amount of P6,932,776.89 (P20,246,262.00 – P13,313,485.11), consistent with the ruling of the Supreme Court in the case of *Commissioner of Internal Revenue vs. Japan Air Lines, Inc., 202 SCRA 455*, that the words 'income from any source whatever' disclose a legislative policy to include all income not expressly exempted within the class of taxable income under our laws, and considering that petitioners failed to prove that said interest income is exempt from the taxable income; the same is, therefore, subject to ordinary corporate income tax under the last paragraph of *Section 130 of the NIRC of 1997, as amended.*

In sum, petitioner PSH's income tax liability for taxable year 2001 is P2,218,488.60, computed, as follows:

Other Income (Income from non-operating activities)	P20,246,262.00
Less: Income subject to final withholding tax	P13,313,485.11
Net Income from non-operating activities	P6,932,776.89
Tax rate:	x 32%
Tax Due	P2,218,488.60

Considering, however, that it is a settled rule that good faith and honest belief that one is not subject to tax on the basis of previous interpretation of government agencies tasked to implement the tax law, are sufficient justification to delete the imposition of surcharges and interest *(Michel J. Lhuillier Pawnshop, Inc. vs. Commissioner of Internal Revenue, 501 SCRA 460)*, the imposition of surcharge and interest on petitioner's income tax liability is hereby deleted.

Third Issue

Whether Petitioner PSH is Liable for Deficiency EWT

In the Formal Letter of Demand dated February 7, 2005, respondent CIR assessed petitioner of deficiency EWT in the total amount of P8,533,851.11, computed as follows:

a) Interest Income not subjected to 20% withholding tax		
Gross amount claimed per 1702	P13,313,485.11	
Tax rate	20%	
Deficiency withholding tax on interest income		**P2,662,697.02**
b) Doctor's Professional Fee not subjected to 10% withholding tax		
Per books (general ledger – A/P)	P48,181,723.48	
Per alpha listing	37,490,770.45	
Difference	P10,690,953.00	
Tax rate	10%	
Deficiency withholding tax on Doctor's Professional Fee		**P1,069,095.30**
c) Contractor's tax		
Payment to Solid Triangle Builders, Inc., represented by Engr. Lauro Tapucar, Jr. not subjected to 2% withholding tax	P68,686,128.32	
Tax rate	2%	
Deficiency withholding tax on Contractor's Fee		**P1,373,722.57**
Total Basic Withholding Tax		**P5,105,514.89**
Add: 25% surcharge		1,276,378.72
Interest (1/25/02 – 2/25/05) (.4166)		2,126,957.50
Penalty		25,000.00
Total Tax Due and Payable		**P8,533,851.11**

a) Deficiency Withholding Tax on Interest Income

As regards the deficiency withholding tax on interest income, as found by the Court-Commissioned Independent CPA, and upon examination of the records, we agree that out of P13,313,485.11 interest income, only the amount of P95,330.66 has been subjected to final withholding tax by the depository banks *(Exhibit "L" of Exhibit "S" and Exhibits "M" to "M-15").* Hence, the amount of P13,218,154.45 (P13,313,485.11–P95,330.66) has not been subjected to final withholding tax.

However, the assessment of deficiency withholding tax on interest income against petitioner PSH is misplaced, as petitioner is not the withholding agent in the instant case. *Section 2.57(A) of Revenue Regulations 2-98* provides, as follows: "Under the final withholding tax system, the amount of income tax withheld by the withholding agent is constituted as a full and final payment of the income tax due from the payee on the said income. The liability for payment of the tax rests primarily on the payor as a withholding agent. Thus, in case of his failure to withhold the tax or in case of under withholding, the deficiency tax shall be collected from the payor/withholding agent. The payee is not required to file an income tax return for the particular income". Hence, pursuant to said provision, the deficiency withholding tax should be collected by the BIR from the payor/withholding agents, which are the depository banks, and not against herein petitioner PSH.

b) Deficiency Withholding Tax on Doctors' Professional Fees

As regards the deficiency withholding tax on Doctors' Professional Fees, records show that out of the total amount of P48,181,723.48 professional fee recorded per books by petitioner PSH, only the amount of P37,490,770.40 has been subjected to 10% creditable withholding tax, as shown in petitioner PSH's Monthly Withholding Tax Returns. Hence, the amount of P10,690,954.08 professional fees for taxable year 2001 has not been subjected to 10% creditable withholding tax, as shown hereunder:

Month	Professional Fees per Books *(Exhibit "N" of Exhibit "S")*	Professional Fees per Monthly Withholding Tax Returns *(Exhibits "R-1" to "R-12")*	Difference	Tax not Withheld by the Hospital (Difference x 10%)
January	P3,850,035.79	P2,821,139.10	P1,028,896.69	P102,889.67
February	4,075,597.50	2,936,588.90	1,139,008.60	113,900.86
March	3,432,546.00	3,156,831.50	275,714.50	27,571.45
April	2,935,329.90	2,603,635.60	331,694.30	33,169.43
May	3,941,396.25	3,396,057.40	545,338.85	54,533.89
June	3,936,304.59	3,019,650.70	916,653.89	91,665.38
July	4,997,522.50	3,582,671.30	1,414,851.20	141,485.12
August	3,793,953.00	2,911,948.40	882,004.60	88,200.46
September	3,923,371.50	2,923,657.00	999,714.50	99,971.45
October	4,418,643.00	3,677,506.10	741,136.90	74,113.69
November	4,209,565.70	3,273,931.10	935,634.60	93,563.46
December	4,667,458.75	3,187,153.30	1,480,305.45	148,030.54
Total	**P48,181,724.48**	**P37,490,770.40**	**P10,690,954.08**	**P1,069,095.40**

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Accordingly, petitioner PSH is liable for deficiency withholding tax on Doctors' Professional Fees for taxable year 2001 in the amount of P1,069,095.40.

c) <u>Deficiency Withholding Tax on Contractor's Fee</u>

As regards the deficiency withholding tax on Contractor's Fee, records show that petitioner PSH paid to Solid Triangle Builders, Inc. for construction services rendered to petitioner PSH the total amount of P68,906,335.91 *(Exhibit "P" of Exhibit "S", Exhibits "Q-1" to "Q-17").* However, no expanded withholding tax of 2%, for the total amount of P1,378,126.72, was withheld, in violation of *Revenue Regulations 12-98*, as amended by *Revenue Regulations 12-01*.

Considering, however, that respondent CIR assessed petitioner PSH of deficiency EWT on Contractor's Fees in the amount of 1,373,722.57 only, then, petitioner PSH can only be held liable of respondent's assessment in the total amount of P1,373,722.57.

As regards the compromise penalty of P25,000.00, settled is the rule that compromise penalties are amounts collected by the BIR in lieu of criminal prosecution for violations committed by taxpayers, the payment of which is based on compromise agreement validly entered into between the taxpayer and the CIR *(Collector of Internal Revenue vs. UST, 104*

Phil. 1062). Absent any showing that petitioner consented to the compromise penalty, its imposition should not be allowed.

In sum, petitioner PSH is liable of deficiency EWT in the total reduced amount of P4,071,200.43, inclusive of surcharge and interest, computed as follows:

Nature of Assessment	Court's Action	Amount
a) Deficiency Withholding Tax on Interest Income	cancelled	
b) Deficiency Withholding Tax on Doctor's Professional Fee	sustained	P1,069,095.40
c) Deficiency Withholding Tax on Contractor's Fee	sustained	P1,373,722.57
Total Basic Expanded Withholding Tax as Found by this Court		**P2,442,817.97**
Add: 25% surcharge		P610,704.49
Interest (1/25/02 – 2/25/05) (.4166)		1,017,677.97
Total Tax Due and Payable		**P4,071,200.43**

<u>*Fourth Issue*</u>

Whether Petitioner PSH is Liable for Deficiency VAT

In the Formal Letter of Demand dated February 7, 2005, respondent assessed petitioner PSH of deficiency VAT in the total amount of P9,423,551.72, computed as follows:

A. VAT deficiency		
Vatable Income per VAT returns	P78,510,221.80	
Divided by Gross Income per 1702 (ITR)	284,729,918.00	
Multiplied by input tax claimed per books	8,857,329.34	
Input tax allowable for year 2001	P2,442,282.53	
Add: Input Tax carried over from previous quarter per VAT returns	1,890,036.08	
Total input tax credits allowed per audit	P4,301,318.61	

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Output tax		P7,851,022.18
Less: Input tax		4,301,318.61
VAT deficiency		P3,549,703.57
B. Overstatement of Input Tax carried over & claimed from 3rd to 4th quarter		
As taken up (per 4th quarter VAT returns)	P4,270,586.97	
Should be	3,284,411.65	
Difference to be accounted for		P986,175.32
Total VAT deficiency		P4,535,878.89
Add: 25% surcharge		1,133,969.72
Interest (2/25/01 – 2/25/05) (.80)		3,628,703.11
Penalties:		
Late filing/payment		P25,000.00
Non-filing of Summary List of Sales & Purchases		100,000.00
Total tax due and payable		**P9,423,551.72**

The assessment is without basis.

In the case of *Commissioner of Internal Revenue vs. Philippine Health Care Providers, Inc., 522 SCRA 138-139*, the Supreme Court ruled, as follows:

> "Section 103 of the same Code *(now Section 109)* specifies the exempt transactions from the provision of Section 102 *(now Section 108)*, thus:
>
> SEC. 103. Exempt Transactions. — The following shall be exempt from the value-added tax:
>
> xxx xxx
>
> (l) Medical, dental, hospital and veterinary services except those rendered by professionals;
>
> xxx xxx

> The import of the above provision is plain. It requires no interpretation. It contemplates the exemption from VAT of taxpayers engaged in the performance of medical, dental, hospital, and veterinary services. In *Commissioner of Internal Revenue v. Seagate Technology (Philippines)*, we defined an exempt transaction as one involving goods or services which, by their nature, are specifically listed in and expressly exempted from the VAT, under the Tax Code, without regard to the tax status of the party in the transaction. In *Commissioner of Internal Revenue v. Toshiba Information Equipment (Phils.) Inc.*, we reiterated this definition."

Pursuant to the above Supreme Court decision, taxpayers engaged in hospital services are exempt from VAT. *Republic Act No. 4226* defines hospital as a place devoted primarily to the maintenance and operation of facilities for the diagnosis, treatment and care of individuals suffering from illness, disease, injury or deformity, or in need of obstetrical or other medical and nursing care *(Section 2(a) thereof)*. In other words, a hospital is a place where persons are given medical or surgical treatment. Hence, hospital services includes not only the services of the doctors, nurses and allied medical personnel, but also the necessary laboratory services, and making available the medicines, drugs and pharmaceutical items that are necessary in the diagnosis, treatment and care of patients. Sale of drugs or pharmaceutical items to in-patients of the hospital are, therefore, considered part of the hospital services covered by *Section 109 (l) of the NIRC of 1997, as amended.*

In this case, the Court-Commissioned Independent CPA found that petitioner PSH derived revenue from operating the hospital for taxable year 2001 in the total amount of P288,746,624.13, P77,424,353.53 of which pertains to pharmacy sales to in-patients and out patients. The Court-Commissioned Independent CPA also found that petitioner PSH pharmacy sales to in-patients and out-patients for taxable year 2001 consist of the following:

	OUT-PATIENTS				IN-PATIENTS				
Month	Cash Sales	Ex-hibit	Charges	Ex-hibit	Charges of Non-Essential Items	Ex-hibit	Charges of Essential Items	Exhibit	Total Pharmacy Sales
Jan	P1,592,634.29	D-1-a	P134,114.86	D-2-a	P61,816.05	D-4-a	P5,054,770.36	D-6-a	P6,843,335.56
Feb	1,257,492.84	D-1-b	192,210.91	D-2-b	50,869.55	D-4-b	4,690,394.87	D-6-b	6,190,968.16
Mar	1,287,241.52	D-1-c	163,177.14	D-2-c	49,857.77	D-4-c	4,229,194.02	D-6-c	5,729,470.45
Apr	1,265,078.05	D-1-d	284,731.32	D-2-d	41,793.91	D-4-d	4,154,386.76	D-6-d	5,745,990.04
May	1,271,766.65	D-1-e	175,895.64	D-2-e	57,819.68	D-4-e	4,354,144.25	D-6-e	5,859,626.21
June	1,432,297.53	D-1-f	259,439.09	D-2-f	52,188.95	D-4-f	5,153,751.69	D-6-f	6,897,677.26
July	1,741,107.60	D-1-g	230,746.36	D-2-g	53,860.23	D-4-g	5,146,691.41	D-6-g	7,172,405.60
Aug	1,739,530.85	D-1-h	375,572.95	D-2-h	62,575.45	D-4-h	4,557,127.73	D-6-h	6,734,806.98
Sept	1,481,670.99	D-1-i	229,273.23	D-2-i	56,337.09	D-4-i	4,093,161.23	D-6-i	5,860,442.54
Oct	1,759,484.66	D-1-j	253,834.50	D-2-j	72,147.23	D-4-j	5,136,217.60	D-6-j	7,221,683.98
Nov	1,794,552.79	D-1-k	249,969.86	D-2-k	40,821.77	D-4-k	4,144,634.25	D-6-k	6,229,978.68
Dec	2,128,077.68	D-1-l	293,906.55	D-2-l	45,027.77	D-4-l	4,470,956.05	D-6-l	6,937,968.05
Total	P18,750,935.44		P2,842,872.41		P645,115.45		P55,185,430.23		P77,424,353.53

(Exhibit "B" of Exhibit "S")

Pursuant to settled jurisprudence, the pharmacy sales exempt from VAT consist of in-patient sales, which are charges of essential items in

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the amount of P55,185,430.23 and charges of non-essential items in the amount of P645,115.45, or for the total amount of P55,830,545.68.

On the other hand, petitioner PSH pharmacy sales that are subject to VAT consist of out-patient sales, which are cash sales of P18,750,935.44 and charges of P2,842,872.41, or for the total amount of P21,593,807.85. Accordingly, the output tax corresponding to total out-patient sales is P2,159,380.79, computed, as follows:

Total VATable Sales	P21,593,807.85
Multiply by VAT rate	10%
Output tax	P2,159,380.79

Having computed the correct output tax, we will now determine the corresponding input tax of petitioner PSH. The Quarterly VAT Returns for taxable year 2001 of petitioner PSH *(Exhibits "J-4", "J-7", "J-10" & "J-13")* reflect the following input VAT:

Month	Purchases inclusive of VAT	Input VAT
First Quarter	P21,916,624.29	P1,992,420.39
Second Quarter	16,059,373.00	1,459,943.00
Third Quarter	34,665,551.80	3,151,413.80
Fourth Quarter	33,216,355.37	3,019,668.67
Total	**P105,857,904.46**	**P9,623,445.86**

However, the Court-Commissioned Independent CPA found that the input VAT of petitioner PSH recorded per books amounts to P9,526,953.20 only. The amount of input VAT, as found by the Court-

Commissioned Independent CPA, being lower than that declared by petitioner PSH in its Quarterly VAT Returns for taxable year 2001, we sustain the Independent CPA's findings. Out of the total input VAT of P9,526,953.20, the Court-Commissioned Independent CPA noted an exception in the total amount of P1,713,238.00, broken down, as follows *(Exhibit "H" of Exhibit "S")*:

Findings	Amount
1) Supporting documents are not VAT-registered	P101,645.23
2) Expenses not incurred within the period	120,692.28
3) Invoices not on file for the purchase of goods	1,490,900.49
Total	**P1,713,238.00**

On the basis of the foregoing, we hereby disallow the amount of P1,713,238.00 from petitioner's input VAT recorded per books. Accordingly, only the amount of P7,813,715.20 input VAT has been duly substantiated.

From the duly substantiated input VAT of P7,813,715.20, records show that the amount of P5,174,291.60 was directly attributable to pharmacy sales, while the amount of P2,639,423.60 was not directly attributable to pharmacy sales.

Considering that only the pharmacy sales of petitioner PSH to out-patients are subject to VAT, then we will allocate the input VAT corresponding to said sales subject to VAT, to wit:

A. Creditable input VAT on input VAT attributable to Pharmacy Sales	= Pharmacy Sales subject to VAT / Total Pharmacy Sales	x Input VAT attributable to Pharmacy Sales
B. Creditable input VAT not directly attributable to Pharmacy Sales	= Pharmacy Sales subject to VAT / Total Hospital Sales	x Input VAT not directly attributable to Pharmacy Sales

Applying the foregoing formula, the input VAT attributable to sales subject to VAT amounts to P1,640,508.63, computed, as follows:

A. Creditable input VAT on input VAT attributable to Pharmacy Sales	P21,593,807.85 / P77,424,353.53	x P5,174,291.60	**= P1,443,120.33**
B. Creditable input VAT not directly attributable to Pharmacy Sales	P21,593,807.85 / P288,746,624.13	x P2,639,423.60	**= 197,388.30**
Total Input Tax Attributable to Sales subject to VAT			**P1,640,508.63**

Therefore, petitioner PSH's VAT payable for taxable year 2001 should have been computed, as follows:

Output tax (Pharmacy Sales) to out-patients only		P2,159,380.79
Less: Input VAT carried over from the previous quarter *(Exhibits "J-2" & "J-4")*	P1,859,036.08	
Creditable input VAT attributable to sales subject to VAT	1,640,508.63	P3,499,544.71
Excess Input VAT		**(P1,340,163.92)**

From the foregoing, it is clear that petitioner PSH has no output VAT liability. Therefore, the deficiency VAT assessment in the amount

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of P9,423,551.72 has no factual and legal basis. Accordingly, the same is hereby cancelled.

In sum, petitioner PSH's tax liabilities are hereby computed, as follows:

Respondent's CIR Assessment		**Court's Findings**	
Nature of Assessment	**Amount**	**Nature of Assessment**	**Amount**
A. Deficiency Income Tax under Section 27 (B) of the NIRC of 1997, as amended	P7,573,328.96	A. Deficiency Income Tax on petitioner PSH's non-operating income, pursuant to the last paragraph of Section 130 of the NIRC of 1997, as amended	**P2,218,488.60**
B. Deficiency EWT		B. Deficiency EWT, as to:	
1) Interest income	P2,662,697.02	1) Interest Income cancelled	
2) Doctor's professional fee	1,069,095.30	2) Doctor's Professional Fee sustained	P1,069,095.40
3) Contractor's fee	1,373,722.57	3) Contractor's Fee sustained	1,373,722.57
4) Penalty	25,000.00	4) Penalty cancelled	
Surcharge	1,276,378.72		610,704.49
Interest	2,126,957.50		1,017,677.97
Total	P8,533,851.11	**Total Deficiency EWT**	**P4,071,200.43**
C. Deficiency VAT	P9,423,551.72	C. Deficiency VAT cancelled	
Total Deficiency Taxes for Taxable Year 2001, as assessed by respondent CIR	P25,530,731.79	**Total Deficiency Taxes for Taxable Year 2001, as found by this Court**	**P6,289,689.03**

WHEREFORE, premises considered, the present Petition For Review is hereby **PARTLY GRANTED**. Accordingly:

1) the deficiency assessment for VAT for taxable year 2001 in the amount of P9,423,551.72 is hereby **CANCELLED and SET ASIDE**;

(initials)

2) petitioner Perpetual Succour Hospital, Inc. is hereby **ORDERED** to **PAY** respondent Commissioner of Internal Revenue the following:

a) the reduced amount of TWO MILLION TWO HUNDRED EIGHTEEN THOUSAND FOUR HUNDRED EIGHTY EIGHT AND 60/100 PESOS (P2,218,488.60), representing deficiency income tax for taxable year 2001; and

b) the reduced amount of FOUR MILLION SEVENTY ONE THOUSAND TWO HUNDRED AND 43/100 PESOS (P4,071,200.43), representing deficiency EWT, inclusive of surcharge and deficiency interest, for taxable year 2001.

SO ORDERED.

OLGA PALANCA-ENRIQUEZ
Associate Justice

WE CONCUR:

JUANITO C. CASTAÑEDA, JR.
Associate Justice

(With Concurring and Dissenting Opinion)
ERLINDA P. UY
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, it is hereby certified that the conclusions in the above Decision were reached in consultation before the cases were assigned to the writer of the opinion of the Court's Division.

ERNESTO D. ACOSTA
Presiding Justice