REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

HOSPICIO DE SAN JOSE,
Petitioner,

-versus - C.T.A. CASE NO. 4660

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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D E C I S I O N

This Petition for Review concerns a deficiency income tax assessments against Petitioner for the taxable years 1981, 1982 and 1983 in the amounts of P434,330.^{75}, P282,928.^{14} and P365,233.^{63}, respectively, inclusive of the sixty (60%) *per centum* maximum deficiency interest.

It appears from the records of the case that on April 15, 1987, Respondent has originally assessed Petitioner the following tax liabilities:

Kind of Tax	Year Involved	Amount Due
1) Deficiency Income Tax	1981	P550,054.^{72}
	1982	368,714.^{37}
	1983	287,469.^{95}

2) Deficiency Expanded Withholding Tax	1981	1,407.53
	1982	1,317.90
	1983	1,229.14
3) Deficiency Privilege Tax	1981	298.87
	1982	278.87
	1983	258.87

Petitioner protested the said assessments in a letter dated May 26, 1987, alleging the following points:

(a) That the expanded withholding tax on professional fees and security guard services were remitted and paid, although late, together with the penalties and interests thereon;

(b) That losses from operations are deductible under Sec. 30(d)(1)(c) of the Tax Code, as authoritatively interpreted in a ruling issued by the Respondent on December 15, 1966. Assuming for the sake of argument that such ruling were to be revoked, the same can be done only prospectively;

(c) That the contributions for the board and lodging of the orphans and other residents did not constitute income;

(d) That there was no factual basis for the assessment for deficiency expanded withholding tax, because the same had been paid, although belatedly, together with the penalties and interest incident to late payment;

(e) That there was no legal basis for the assessment of the deficiency privilege tax because the taxpayer was not engaged in the business of providing board and lodging to the orphans and other indigent residents.

Respondent, in a letter dated July 29, 1991, received by Petitioner on September 23,1991, resolved petitioner's protest by -

(a) revoking the deficiency assessments for expanded withholding tax and privilege tax;

(b) deleting contributions for board and lodging of the residents as part of gross income; and

(c) insisting on the disallowances of expenses for professional fees and security guard services and of operating losses.

As a result, Respondent made reassessments of petitioner's the deficiency income taxes for 1981, 1982 and 1983 in the respective amounts of P434,330.75, P282,928.14 and P365,233.63.

Respondent, in her answer, cited the case of **Hospicio de San Jose vs. Commissioner of Internal Revenue**, CTA Case No. 4224, involving the same issue, and alleged that the intent of Section 27 of the NIRC 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 and other exempt purpose. In other words, the taxable income of such organization should be treated as separate and distinct from their tax exempt income for purposes of taxation. Accordingly, the loss suffered by Petitioner from its fully exempt operation cannot be allowed as deduction from its taxable income.

Furthermore, reliance by petitioner on the ruling of Dec. 15, 1966 by the BIR is not in accordance with law and the government is not precluded from collecting such tax which is legally due it citing cases of **Hilado vs. Collector of Internal Revenue**, 100 Phil. 288 (1956), **Zapata Marine Services, Ltd. S.A. vs. Court of Tax Appeals, et al.**, G.R. No. 80046, (April 18, 1988).

The issues to be resolved by this court are as follows:

(1) Whether or not the operating losses from tax exempt activities of petitioner may be deducted from its taxable income;

(2) Assuming that the BIR Ruling of December 15, 1966 may be revoked, whether or not the revocation may be done retroactively;

(3) Whether or not expenses for professional fees and security guard services are deductible from gross income for failure to withhold taxes on time.

The first two issues have already been answered by this court in a similar case involving the same parties. This is in the case of Hospicio de San Jose, Petitioner vs. Commissioner of Internal Revenue, Respondent, C.T.A. Case No. 4224, February 28, 1991. When appealed to the Court of Appeals, the higher court, in Commissioner of Internal Revenue, Petitioner vs. Hospicio de San Jose, and the Court of Tax Appeals, CA-G.R. SP No. 25356, July 2, 1992, affirmed *in toto* the decision of this court. Said court has this to say:

> "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 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.

On the second issue of retroactivity, the same was likewise resolved in favor of the government. However, for reason of good faith and justice, Petitioner should not be subject to the amount of interest for relying in good faith in the BIR's previous ruling. The court ruled as follows:

> 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 V-123, having been issued on a wrong construction of the law, cannot give rise to a vested right that can be invoked by the taxpayer. The reason is obvious: a vested right cannot spring from a wrong interpretation. This is too clear to require elaboration.
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> "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 tax which is legally due".

On the third issue, this court believes that Revenue Memorandum Order No. 38-83 dated November 14, 1983, entitled "Guidelines for Allowances of

Deductions for Certain Income Payments Under Section 30(1) of the Tax Code", should apply in the final resolution of this issue. The pertinent provisions thereof are as follows:

> Guidelines for Applying Section 30(1)
>
> An amount claimed as deduction on which a tax is supposed to have been withheld under Sections 54 and 93 shall be allowed if in the course of his audit and/or investigation, the examiner discovers that:
>
> 3.1/1 No withholding of creditable or final tax was made but the payee reported the income and the withholding agent/taxpayer pays during the original audit and investigation the surcharges, interest and penalties incident to the failure to withhold the tax.
>
> 3.1/2 No withholding or creditable or final tax was made and the recipient-payee failed to report the income on due date thereof, but the withholding agent pays during the original audit and investigation the amount supposed to have been withheld, inclusive of surcharges, interest and penalties incident to his failure to withhold.
>
> 3.1/3 The withholding agent erroneously underwithheld the tax but pays during the original audit and investigation the difference in the amount supposed to have been withheld, inclusive of surcharges, interest and penalties incident to such error. (Underscoring supplied.)

Clearly under said regulation, if the proper withholding tax is paid during the period of original audit and investigation, the amount claimed as deduction shall be allowed. The records of the case will show that the deficiency expanded withholding tax in the amounts of P1,407.$^{\underline{53}}$ for 1981, P1,317.$^{\underline{90}}$ for 1982 and P1,229.$^{\underline{14}}$ for 1983, were paid by the Petitioner on August 19, 1985 inclusive of interest, surcharge and compromise penalties under Confirmation Receipt (C.R.) Nos. 7280780, 7280781, 7280783 and 7280784 for 1981, C.R Nos. 7280785, 7280787, 7280789 and 7280783 for 1982 and C.R. Nos. 7280793, 7280794, 7280795 and 7280796 for 1983. Said payments were made during the progress of the investigation.

Accordingly, the foregoing assessments should be recomputed by excluding therefrom the expenses for professional fees and security guard services as well as the interest imposed on the basic income tax. Petitioner's tax liabilities for the years in question should therefore be recomputed as follows:

Recomputation of Deficiency Income Tax:

	1981	1982	1983
Net income/(loss) per return	2,003,927.18	(829,792.33)	(586,971.28)

Add: Net loss on exempt operations	1,938,610.88	2,021,081.71	2,094,324.22
Net income per Court's computation	3,942,538.06	1,191,289.38	1,507,352.94
Less: Income subject to final tax			
Dividend	138,509.76	325,140.24	486,649.18
Interest	2,961,466.80	286,733.10	290,294.22
Total	3,099,976.56	611,873.34	776,943.40
Adjusted net income	842,561.50	579,416.04	730,409.54
Tax due	284,896.52	192,795.61	245,643.34
Less: Taxes withheld	18,227.80	20,753.52	21,922.32
Deficiency income tax	266,668.72	172,042.09	223,721.02

WHEREFORE, in view of all the foregoing, Petitioner is ordered to pay the amounts of P266,668.72, P172,042.09 and P223,721.02 as deficiency income tax for taxable years 1981, 1982 and 1983, respectively, or a total of P662,431.83.

SO ORDERED.

Quezon City, Metro Manila, December 24, 1993.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
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 among the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals