Library

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

THE LUTHERAN CHURCH-MISSOURI SYNOD, (THE LUTHERAN PHILIPPINE MISSION, subsidiary),
Petitioner,

- versus - C.T.A. CASE No. 2000

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

11/17/72

x - - - - - - - - - - - - - - x

D E C I S I O N

Two causes of action are presented in this petition; first, the refund of alleged exempt income taxes amounting to ₱5,578.26 for the years 1961 to 1966, inclusive of interests and compromise penalties; and second, the refund of ₱600.00 representing compromise penalty paid for alleged violation of Revenue Regulations No. V-1, in relation to Section 334 of the Revenue Code.

Petitioner is a religious corporation duly organized and existing under the laws of the State of Missouri, U.S.A., and duly licensed to transact business in the Philippines with principal office at 4461 Old Sta. Mesa, Sampaloc, Manila. On April 19, 1965, petitioner filed with respondent an application for exemption from income tax under Revenue Regulations No. 7-64.

Sometime in April, 1967, respondent assessed and demanded from petitioner payment of the following deficiency income tax, interest and compromise penalty on interests income earned from petitioner's bank deposits, to wit:

For Year	Deficiency Income Tax	Interest	Compromise Penalty	Total
1961	₱ 19.86	₱ 6.84	₱ 20.00	₱ 46.70
1962	213.56	76.88	20.00	310.44
1963	1,278.44	460.24	20.00	1,758.68
1964	1,370.62	328.95	20.00	1,719.57
1965	835.09	100.21	20.00	955.30
1966	788.17	------	-----	788.17

(par. 3, Pet. p. 2, CTA rec.; Admitted in par. 2, Ans. p. 56, CTA rec.)

Payments were made by petitioner under the following dates, official receipt numbers, and amounts, to wit:

Date	O. R. No.	Amount
April 15, 1967	0881499	₱ 788.17
April 25, 1967	0969926	46.10
April 25, 1967	0969927	310.44
April 25, 1967	0969928	1,758.68
April 25, 1967	0969929	1,719.57
April 25, 1967	0969930	955.30
	T O T A L - - -	₱ 5,578.26

On April 20, 1967, petitioner sought respondent's opinion on whether or not it is subject to income tax on the interests income earned from its bank deposits. (Annex F, p. 33, CTA rec.) This inquiry was answered by respondent in the affirmative and ruled that the interests earned by petitioner are subject to income tax.

On February 27, 1969, petitioner filed a written claim for the refund of the aforementioned taxes but the same was not acted upon by respondent.

On March 25, 1969, petitioner received another notice, Assessment No. 705247-65 dated March 15, 1969, requiring payment of ₱600.00 as compromise penalty for alleged violation of Revenue Regulations No. V-1, in relation to Section 334 of the National Internal Revenue Code.

Petitioner paid under protest the compromise penalty of ₱600.00 under Official Receipt No. 1332658, dated March 31, 1969. (par. 14, Pet. p. 4, CTA rec.; Admitted in par. 2, Ans. p. 56, CTA rec.)

On April 1, 1969, petitioner filed a claim for the refund thereof, but respondent failed and still fails to take any action thereon. Petitioner, therefore, interposed this appeal on April 12, 1969 to contest respondent's assessment and to preserve its right of refund under the provisions of Section 306 of the Revenue Code.

After the trial of the case on the merits, both parties submitted the same to this Court for decision without memoranda.

From the pleadings and records, the two (2) issues posed for resolution of the Court are the following:

1. Whether or not petitioner is legally entitled to the refund of ₱5,578.26 paid by it on April 15 and 25, 1967 as income tax and penalties on the interests earned from bank deposits; and

2. Whether or not petitioner is entitled to the refund of ₱600.00 paid by it as a compromise penalty for violation of the Bookkeeping Regulations.

FIRST ISSUE:

Petitioner claimed that it is exempt from income tax because the interests earned by it from bank deposits are only incidental to its activities as a religious corporation; all of its operating funds, capital, and subsidies came from The Lutheran Church-Missouri Synod; the mother church in the United States sends the same to the Philippines and said funds remained in local banks as deposit if they are not needed by petitioner in its religious operations or spent for the purchase of land and churches to be constructed thereon; and said funds were deposited in banks for safekeeping and convenience and not for gain or profit.

Respondent contends, however, that said deposits are investment in the nature of loans to the bank - the depositor being the lender; and the interests earned by the depositor represent profit or gain subject to income tax.

The interests earned by petitioner from its bank deposits represent profit in the course of its transactions. Thus, it was held:

> Coming to group (d), that is, interests on plaintiff-appellant's bank deposits, in the amount of ₱448.65 the tax on which is ₱4.49, there is no doubt said group represents profit of the company made in the course of its regular transactions in connection with its franchises. (Philippine Long Distance Tel. Co. v. Collector of Internal Revenue, 90 Phil. 680, January 21, 1952; underscoring supplied)

Under our Income Tax Law, interests earned constitute a part of the gross income of a corporation or individual. The pertinent provisions on the matter read as follows:

> Sec. 29. Gross income. - (a) General definition.
> Gross income includes xx xx interests, rents, dividends, securities, or transactions of any business carried on for gain or profit, or gains, profits, and income derived from any source whatever. (National Internal Revenue Code)

After holding that the interests earned by petitioner from its bank deposits represent profit includible in its gross income, it may be asked: Is petitioner entitled to the refund of the income taxes and penalties due thereon after it had lost the right to dispute respondent's assessment in the Court of Tax Appeals within the 30-day period prescribed by Section 11 of Republic Act No. 1125? Our Supreme Court, speaking thru Mr. Justice Enrique Fernando, answered the question in the affirmative. Thus, in the case of Commissioner of Internal Revenue v. Jose Concepcion, et al., G. R. No. L-23912, March 12, 1968, it was held:

> In the petition for the review of a decision of the Court of Tax Appeals, the decisive question, one of first impression, is whether a taxpayer who had lost his right to dispute the validity of an assessment, the period for appealing to the Court of Tax Appeals having expired, as found by such Court in a previous case in a decision now final, and who thereafter paid under protest could then, relying on Section 306 of the National Internal Revenue Code sue for recovery on the ground of its illegality? The Court of Tax Appeals, in the decision under review, answered in the affirmative. We held otherwise and accordingly reverse.

In this case, petitioner was assessed by respondent sometime in April 1967 for deficiency income tax, interest and compromise penalty on interests income earned from petitioner's bank deposits. Petitioner paid to the Government on April 15 and 25, 1967 a total of ₱5,578.26 on the basis of respondent's assessment. On April 20, 1967, petitioner sought respondent's opinion on whether or not it is subject to income tax on the interests income earned from its bank deposits and the said respondent answered the query in the affirmative. Consequently, under Section 11 of Republic Act No. 1125, petitioner has 30 days after the receipt of respondent's decision or ruling within which to appeal the disputed assessment to the Court of Tax Appeals. Petitioner, however, failed to do so. Its appeal was only made on April 12, 1969.

Having failed to appeal on time from the decision of respondent, petitioner cannot sue for the recovery of the income taxes and penalties paid in April 1967 by relying on the two-year period prescribed for refund under Section 306 of the National Internal Revenue Code. In justifying the ruling in the Concepcion case, supra, our Supreme Court said:

> For subsequently, in Republic v. Lim Tian Teng Sons & Co., Inc. (L-21731, March 31, 1966), the above doctrine was reaffirmed categorically in this language: "Taxpayer's failure to appeal to the Court of Tax Appeals in due time made the assessment in question final, executory and demandable.: And when the action was instituted on September 2, 1958 to enforce the deficiency assessment in question, it was already barred from disputing the correctness of the assessment or invoking any defense that would reopen the question of his tax liability on the merits. Otherwise, the period of thirty days for appeal to the Court of Tax Appeals would make little sense." Once the matter has reached the stage of finality in view of the failure to appeal, it logically follows, in the appropriate language of Justice Makalintal, in Morales vs. Collector of Internal Revenue (L-16759, August 31, 1966), that it "could no longer be reopened through the expedient of an appeal from the denial of petitioner's request for cancellation of the warrant of distraint and levy."
>
> In the same way then that the expedient of an appeal from a denial of a tax request for cancellation of warrant of distraint and levy cannot be utilized for the purpose of testing the legality of an assessment, which had become conclusive and binding on the taxpayer, there being no appeal, the procedure set forth in Section 306 of the National Internal Revenue Code is not available to revive the right to contest the validity of an assessment once the same had been irretrievably lost not only by the failure to appeal but likewise by the lapse of the reglementary period within which to appeal could have been taken. xx xx.

Inspite of the ruling of the Supreme Court in the Concepcion case, supra, which precluded petitioner from obtaining the refund sought for, both parties apparently invoked as a basis for exemption from or liability to income tax the provisions of Section 27(e) of the Revenue Code which read as follows:

> SEC. 27. Exemption from tax on corporations.-- The following organizations shall not be taxed under this Title in respect to income received by them as such--
>
> x x x x x x
>
> (e) Corporation or association organized and operated exclusively for religious, charitable, scientific, athletic, cultural, or educational 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; Provided, however, That the income of whatever kind and character from any of its properties, real or personal, or from any activity conducted for profit, regardless of the disposition made of such income shall be liable to the tax imposed under this Code; (Underlining Supplied)

In holding that the interest earned by a religious corporation is subject to income tax regardless of the disposition made of such income, this Court in the case of Congregacion de la Mission de San Vicente de Paul v. Commissioner of Internal Revenue, CTA Case No. 1468, October 14, 1969, held as follows:

> There is no dispute that the income in question consists of rents, interest, and dividends of petitioner's real and personal properties. Having originated from the productive use of petitioner's properties which are not essential to, or necessarily connected with its religious, charitable, and educational pursuits, the said income is subject to income tax even if it was turned over to and spent by St. Vincent Seminary, a corporation operated for religious and charitable purposes. The final and ultimate destination of petitioner's income from the rental of its real proper-

ty; dividends from investments in mining, insurance, and commercial corporations; and interests from loans or deposits did not render it exempt from income tax under Section 27(e) and (k) of the Tax Code because the income from any activity conducted for profit is subject to income tax under the amendatory law (Sec. 5, Rep. Act No. 82). (See also the ruling in the case of Xavier School, Inc. v. Comm. of Int. Rev., CTA Case No. 1682, Oct. 8, 1969.)

In the cases of San Vicente de Paul, supra, and Xavier School, Inc. v. Comm. of Int. Rev., CTA Case No. 1682, October 8, 1969, the meaning, scope and effect of Sec. 27(e), as amended by Sec. 5, Republic Act No. 82, were underscored in this wise:

> The history of Section 27(e) of the Tax Code, before its amendment by Section 5, Republic Act No. 82, and the decisions of our Supreme Court interpreting the same were embodied in Opinion No. 45, Series of 1956, of the Hon. Secretary of Justice. The said official also expounded on the meaning, scope, and effect of the amendatory provisions contained in Section 5, Republic Act No. 82, in the following language:
>
> > "We have examined the history of this legal provision which was originally found in section 2, paragraph G(a) of the Act of Congress of the United States of 1913. The proviso was first engrafted into the statute by Act No. 2833 (approved on March 7, 1919); it 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.' Despite its sweeping import, the Supreme Court, in the case of Bishop of Nueva Segovia v. Collector of Internal Revenue (50 Phil. 618), held that 'the proviso in question has not resulted in taking the income of the plaintiff, consisting of 'rents on land, dividends . . interests on loans . . . etc.'. . . out of the operation of the exemption contained in the law.' Reiterating

the ruling laid down in Sagrada Orden de Predicadores v. Trinidad (42 Phil. 397, 263 U.S. 578) that destination of the income was the ultimate test of the exemption, the Supreme Court reversed the judgment of the lower court sustaining the assessment of income taxes on said income of the plaintiff, it appearing that the same was used for carrying on the plaintiff's religious charitable and educational work.

"Such was the law, as construed judicially and as applied by administrative officers, when the proviso was again amended in 1946 by Republic Act No. 82. <u>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.</u> 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.'

"Another significant change in the proviso is the insertion of the phrase, '<u>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</u>. The meaning and scope of this phrase was the bone of contention in the case of Jesus Sacred Heart College v. Collector of Internal Revenue (G.R. No. L-6807, prom., May 24, 1954). The defendant assessed and collected income taxes on plaintiff's income from tuition and other fees. In rendering judgment in favor of the plaintiff, whose claim for refund was found meritorious by the Court of First Instance of Manila, the Supreme Court said, <u>inter alia</u>, in regard to this particular amendment, that 'Congress had no intention of taxing matriculation, laboratory, library, athletic and graduation fees and other fees of similar nature, essential to, or necessarily connected with, the educational purposes of an institution of learning' (underscoring mine). Accordingly, only the income derived by an exempt entity from the pursuit of a business or undertaking not essential to, or not necessarily connected with, its educational or other exempt purposes would be taxable under this amendment.

"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 organizations therein specified only to the extent of withdrawing the exemptions with respect to income realized (a) from the productive use of their real and personal properties e.g., rents, dividends, or interest -- (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. . . ." (Emphasis and underscoring supplied.)

We are in accord with the views expressed by the Hon. Secretary of Justice as to the meaning, scope and effect of Section 27(e) of the Tax Code, as amended by Section 5 of Republic Act No. 82.

We see no plausible reason to deviate from the foregoing doctine doctrine which is equally applicable to the instant case.

SECOND ISSUE:

Respondent assessed petitioner the sum of ₱600.00 for alleged violation of Revenue Regulations No. V-1 (Bookkeeping Regulations), in relation to Sec. 334 of the Revenue Code. Petitioner paid the same under protest on March 21, 1969 and instituted this action on April 12, 1967, or 12 days after the date of payment and less than 30 days from the date of assessment on March 15, 1969.

Compromise implies mutual agreement between the parties involved in the compromise. One party cannot exact from or impose upon another a compromise. If the Commissioner believes that the taxpayer has incurred a criminal liability for violation of the Revenue Code, he is free to institute criminal proceedings against the offender; but for the Commissioner to impose a penalty is clearly illegal and unauthorized. (Coll. of Int. Rev. v. U.S.T. 104 Phil. 1062; Coll. of Int. Rev. v. Bautista, 105 Phil. 1326; Phil. Int'l Fair, Inc. v. Coll. of Int. Rev., 4 SCRA 774.) Consequently, the sum of ₱600.00 was illegally collected when petitioner protested the payment of the compromise penalty. Respondent could only suggest to the taxpayer the payment of a compromise penalty but not the imposition thereof.

The prayer for the payment of the legal rate of interest on the amount to be refunded cannot be justified unless the collection of the internal revenue tax is attended with arbitrariness. (Comm. of Int. Rev. v. Asturias Sugar Control, 3 SCRA 727)

WHEREFORE, petitioner's claim for the refund of income tax and penalties in the amount of ₱5,578.26 is hereby denied. As to the compromise penalty of ₱600.00, the claim for the refund thereof is well taken. Accordingly, respondent is hereby ordered to refund to petitioner the said amount of ₱600.00. Without pronouncement as to costs.

SO ORDERED.

Quezon City, November 17, 1972.

ESTANISLAO R. ALVAREZ
Associate Judge

I CONCUR:

RAMON L. AVANCEÑA
Associate Judge

Presiding Judge ROMAN M. UMALI is on leave.