REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

SECOND DIVISION

PROFESSIONAL SERVICES, INC., Petitioner,	**C.T.A. CASE NO. 7381**
	Members:
- versus -	**CASTAÑEDA, JR.,** *Chairperson* **UY,** *and* **PALANCA-ENRIQUEZ,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** MAR 17 2008 11:00 a.m.

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DECISION

CASTAÑEDA, JR., *J*.:

Before the Court is a Petition for Review praying for the withdrawal and cancellation of the Formal Letter of Demand dated March 17, 2005 and the Preliminary Assessment Notice dated January 2005 for being void; and for the issuance of an order against respondent to desist from collecting the alleged deficiency assessments for taxable year 2001.

Professional Services, Inc. (petitioner) is a corporation whose primary purposes are "[t]o establish, operate, manage, own and maintain a hospital or hospitals, medical and chemical clinics or laboratories and such other enterprises which may have similar or analogous undertakings or dedicated services in connection therewith, and to do any and all things and to enter into any and all kinds of transactions that will achieve the purposes so mentioned, provided that purely professional medical or surgical services in connection therewith 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."[1]

Petitioner owns and operates the New Medical City hospital; a licensed tertiary hospital located at The Medical City Complex, Ortigas Avenue, Pasig City.[2]

On March 4, 2005, petitioner received from respondent a Preliminary Assessment Notice (PAN) for deficiency income and value-added taxes for the taxable year 2001, computed as follows:[3]

Kind of Tax	Basic	Surcharge	Interest	Compromise	Total
Income Tax	4,468,700.22	0.00	2,568,584.40	25,000.00	7,062,284.62
Value Added Tax	20,326,211.80	0.00	12,574,407.19	25,000.00	32,925,618.99
TOTAL	24,794,912.02	0.00	15,142,991.59	50,000.00	39,987,903.61

On March 18, 2005, respondent received petitioner's letter-protest dated March 17, 2005, to the PAN for the taxable year 2001.[4]

On April 15, 2005, petitioner received from respondent a Formal Letter of Demand dated March 17, 2005, demanding payment of deficiency income and value-added taxes computed as follows:[5] gr

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[1] Par. 1, Joint Stipulation of Facts and Issues to be Resolved, Docket, p. 93.
[2] Par. 2, Joint Stipulation of Facts and Issues to be Resolved, Docket, p. 94.
[3] Par. 3, Joint Stipulation of Facts and Issues to be Resolved, *ibid.*; Exhibit "C".
[4] Par. 4, Joint Stipulation of Facts and Issues to be Resolved, *ibid.*
[5] Par. 5, Joint Stipulation of Facts and Issues to be Resolved, *ibid.*; Exhibit "A".

Income Tax

Basic Tax Due (unsupported CWT per audit)		P4,468,700.22
Add: 20% Interest	P2,867,313.95	
Compromise Penalty	25,000.00	2,892,313.95
Total Amount Still Due		**7,361,014.17**

Value Added Tax

Taxable sales per audit		203,262,118.00
Output tax due		-20,326,211.80
Less: Creditable input tax	0.00	
Tax withheld/paid per return	0.00	0.00
Basic Tax Due		20,326,211.80
Add: 20% Interest	13,933,200.53	
Compromise Penalty	25,000.00	13,958,200.53
Total Amount Still Due		**34,284,412.33**
TOTAL		**41,645,426.50**

Further, in two Audit Result/Assessment Notices INC No. 01-000144 and VT No. 01-000165, both dated April 15, 2005, respondent informed petitioner of its deficiency income tax in the amount of P7,361,014.17 arising from the tax credits granted to senior citizens under Section 4 of Republic Act (RA) 7432 and Revenue Regulations (RR) 2-94 and deficiency value-added tax in the amount of P34,284,412.33 arising from its sales of pharmacy medicines under RR No. 10-94.[6]

Petitioner filed its Formal Protest to the Final Demand Letter, with supporting documents, to strengthen its claim that it is not liable for any deficiency tax assessment.[7]

As the one hundred eighty (180)-day period within which to render decision on the protest expired on November 9, 2005, petitioner filed before this Court the present Petition on December 9, 2005.[8]

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[6] Par. 6, Joint Stipulation of Facts and Issues to be Resolved, Docket, p. 95; Exhibits "E" and "F".
[7] Par. 7, Joint Stipulation of Facts and Issues to be Resolved, *ibid.*

Respondent raised the following counterarguments in his Answer:

1. The assessment issued by respondent has become final and executory;

2. The term "tax credit" as used in RA 7432 is not the literal "tax credit" as used in the National Internal Revenue Code; and

3. The sale of drugs to in-patients is subject to VAT on sales of goods.

Trial proceeded and only petitioner presented its testimonial and documentary evidence after the Court declared respondent to have waived his right to present evidence[9]. The case was submitted for decision on July 4, 2007 after both parties filed their respective Memorandum.

The issues[10] as stipulated by the parties are as follows:

"1. Whether or not the *Formal Protest to the Final Demand Letter* was filed on time by Petitioner via registered mail on May 13, 2005. Corollary thereto, whether or not the assessment has become final, executory, and demandable.

2. Whether or not the sale of pharmacy drugs/medicine to in-patients are VAT-able receipts; or stated otherwise, whether or not the sale of pharmacy drugs/medicine to in-patients fall within the purview of Section 109(1) of the National Internal Revenue Code (NIRC), as amended.

3. Whether or not the 20% discount on purchase of medicine granted by Petitioner in year 2001 to senior citizens should be treated as a deduction from gross sales/income as interpreted in Revenue Regulation No. 2-94, or as a tax credit under Republic Act 7432 and as defined under the NIRC."

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[8] Par. 8, Joint Stipulation of Facts and Issues to be Resolved *ibid.*
[9] Resolution dated May 10, 2007, Docket, p. 199.
[10] Joint Stipulation of Facts and Issues to be Resolved, Docket, p. 96

First Issue: Whether the Assessment became final, executory, and demandable

Section 228 of the National Internal Revenue Code (NIRC) of 1997, as amended, lays down the procedure in protesting an assessment. It reads:

> "SEC. 228. *Protesting of Assessment.*- When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: *Provided, however,* That a preassessment notice shall not be required in the following cases:
>
> xxx xxx xxx
>
> The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.
>
> Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to said notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.
>
> Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.
>
> If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of the one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable."

As stipulated by the parties and as it appears from the records of the case, petitioner received the Formal Letter of Demand, together with the attached Briefer, and the Assessment Notice Nos. INC-01-000144 and VT-01-

000165 on April 15, 2005. Thus, petitioner had thirty (30) days or until May 16, 2005 within which to file its protest.[11]

Basic is the rule that when a mail matter was received by registered mail, there exists a presumption that it was received in the regular course of mail as provided in Section 3(v), Rule 131 of the Revised Rules of Court. And in order to raise this presumption, it must be proven that: (1) the letter was properly addressed with postage prepaid; and, (2) it was mailed.

To prove that it filed a protest within the reglementary period, petitioner presented the following exhibits:

1. Exhibit "K" Affidavit of Mr. June B. Rojas, paralegal of The Bengzon Law Firm, stating that he filed the *Protest on the Formal Letter of Demand* by registered mail, with Registry Receipt No. 22224, on May 13, 2005 at the Makati Central Post Office;

2. Exhibit "L" Affidavit of Ms. Candelaria A. Ponciano, employee of petitioner, stating that she received a copy of the *Protest on the Formal Letter of Demand* on May 12, 2005;

3. Exhibit "I" Makati Central Post Office Registry Receipt No. 22224; and

4. Exhibit "J" Makati Central Post Office Certification, dated April 11, 2006, with an attached Inquiry Form on Domestic Recorded Mail.

The Certification issued by Ms. Emily A. Gianan, Chief of the Administrative Unit of the Philippine Postal Corporation, and the Inquiry Form on Domestic Recorded Mail show that the counsel for petitioner sent a letter to the Bureau of Internal Revenue (BIR) by registered mail on May 13, 2005.[12]

[11] May 15, 2005 fell on a Sunday.
[12] Exhibit "J."

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Petitioner's witness, Mr. June B. Rojas, attested to the facts that the letter-protest was filed by registered mail before the lapse of the prescribed period and that no return card was received.[13]

As the Revised Rules of Court shall apply by analogy or in a suppletory character,[14] the date of the mailing of pleadings, motions, and other papers, as shown by the post office stamp on the envelope or the registry receipt, shall be considered as the date of their filing and the envelope shall be attached to the record of the case.[15] Hence, the *Protest on the Formal Letter of Demand* was deemed to have been filed on May 13, 2005.

In ***Gold Line Transit, Inc. v. Luisa Ramos***[16], the Supreme Court ruled that "xxx postal officials enjoy the presumption, without clear and convincing evidence to the contrary, to have regularly performed their official duty and that they have acted in good faith. *Omnia praesumuntur rite et solemniter esse acta donec probetur in contrarium.* All things are presumed to have been done correctly and with due formality until the contrary is proved. For another reason, mails are presumed to have been properly delivered and received by the addressee 'in the regular course of the mail.' These *juris tantum* presumptions stand even against the most well-reasoned allegations pointing to some possible irregularity or anomaly."

As the presumption exists in favor of petitioner, respondent has the burden of proving that petitioner's protest to the FAN was actually mailed after the prescriptive period by presenting the mail envelope used by petitioner duly

[13] Exhibit "K."
[14] Section 4, Rule 1 of the Revised Rules of Court.
[15] Section 3, Rule 13 of the Revised Rules of Court.
[16] G. R. No. 144813, August 15, 2001.

stamped by the Philippine Postal Corporation showing the date when the protest was sent by registered mail. And, this Court finds that respondent failed to discharge the burden as there appears to be no controverting evidence to prove his assertion that petitioner failed to file its protest on time.

Second Issue: Whether the sale of pharmacy drugs/medicine to in-patients is subject to VAT under Section 109(l) of the NIRC

Section 109 of the NIRC of 1997, as amended provides:

> "SEC. 109. Exempt Transactions. — The following shall be exempt from the value-added tax:
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> xxx xxx xxx
>
> (l) Medical, dental, hospital and veterinary services subject to the provisions of Section 17 of Republic Act No. 7716, as amended;
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> xxx xxx xxx."

In ***St. Luke's Medical Center, Inc. vs. Court of Tax Appeals and The Commissioner of Internal Revenue***[17], the Court of Appeals interpreted the phrase "hospital services" to include sale of pharmaceutical items to in-patients, to quote:

> "The value-added tax is a tax imposed on any person who in the course of trade or business, sells goods or renders services, or imports goods (Sec. 99, NIRC). The 10% value-added tax on sale of goods is imposed by Section 100, while the value-added tax on sale of services is imposed by Section 102. Section 103 enumerates the transactions exempt from the value-added tax, among others:
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> '(l) medical, dental, hospital and veterinary services . . . and

[17] CA-G.R. SP No. 45892, March 13, 1998.

(w) sales and/or services performed by persons other than those mentioned in the preceding paragraphs whose annual, gross sales and/or receipts do not exceed the amount prescribed in regulations to be promulgated by the Secretary of Finance which shall not be less than P100,000.00 or higher than P500,000.00.'

We agree with petitioner that the item 'hospital services' in Section 103 (1) should include sales of drugs to in-patients of the hospital. 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. In the legal sense, a hospital is an institution devoted primarily to the 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), R.A. 4226). In its ordinary acceptation, it is a place where persons are given medical or surgical treatment. A person who resorts to the hospital for medical treatment can reasonably expect that the hospital would make available to its patients immediate and prompt access not only to the services of doctors, nurses and allied medical personnel, but also to necessary laboratory services as well as medicines, drugs and pharmaceutical items which are indispensable aids in practically any form of medical treatment and care of patients. 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 103(1) of the Tax Code for 'hospital services'. A contrary view would derogate from the evident laudable purpose animating the exemption of 'hospital services'.

Rationally, no suggestion is made by petitioner that sales to non-patients or outsiders, which is indubitably a simple sale of goods, would be an exempt transaction.

We accordingly opine that the sale of drugs or pharmaceutical items to in-patients of the hospital should be exempted from VAT because unlike the sale of retailing of drugs or medicines by drugstores in general, the procurement of medicines and pharmaceutical items from the hospital drugstore or pharmacy amounts to the availment of service rendered or made available by the hospital for its in-patients and not simply the buying of such goods." (*Emphasis supplied*)

This Court finds no reason to depart from the above ruling.

Under RA 4226[18], a "hospital" is defined 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. The term 'hospital' shall also be construed as any institution, building or place where there are installed beds or cribs or bassinets for twenty-four hour use or longer by patients in the treatment of diseases, diseased-condition, injuries, deformities or abnormal physical and mental states, maternity cases, and sanitorial or sanitarial care infirmities, nurseries, dispensaries, and such other means by which they may be designated." 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," necessarily includes providing medicines, drugs and pharmaceutical items indispensable for the treatment and care of the in-patients. Such sales of medicines, drugs and pharmaceutical items to in-patients are part of the "hospital service"; and, thus, exempt from VAT as provided by Section 109(l) of the NIRC of 1997, as amended.

Third Issue: Whether the 20% discount on purchase of medicines granted by petitioner to senior citizens in the year 2001 should be treated as deduction from gross sales/income or as a tax credit.

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[18] Hospital Licensure Act.

This Court has consistently held that the 20% sales discounts granted to qualified senior citizens should be treated as tax credit and not as mere deductions from gross income.[19]

In ***Del Rosario Drug Corporation vs. Commissioner of Internal Revenue***,[20] this Court declared:

> "A cursory review of the wordings of Section 4 of Republic Act No. 7432 would reveal that the law literally intended the cost of the 20% discount to be claimed as tax credit by private establishments. We could not see any plausible reason for the respondent to interpret the phrase in a different way. The discount being available for tax credit as stated in the law cannot be made incoherent to mean that such discount be utilized instead as a deduction from gross income and from gross sales as what is provided in RR No. 2-94.
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> To be valid, an administrative regulation must not be in contravention but should conform to the standards that the law prescribes. (*Tayug Rural Bank vs. Central Bank*, 146 SCRA 12). Its promulgation must be authorized by the legislature. (Philippine Administrative Law, Cruz, 1994 ed., p.32)
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> RR No. 2-94 which engraved a new meaning to the phrase 'tax credit' as referring to the 20% discount which is deductible from gross sales is patently incongruous and a deviation from the plain intendment of the law. It is even repugnant to the common dictionary acceptation of said phrase.
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> Black's Law Dictionary, 6th ed., defines tax credit in this wise:
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>> An amount subtracted from an individual's or entity's tax liability to arrive at the total tax liability. A tax credit reduces the taxpayer's liability dollar for dollar, compared to a deduction which reduces taxable income upon which the tax liability is calculated. *A credit differs from deduction to the extent that the former is subtracted from the tax while the latter is subtracted from income before the tax is computed.* (Emphasis supplied)

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[19] *Baliuag Drug Corp. vs. Commissioner of Internal Revenue*, C.T.A. Case No. 6537, November 25, 2004, quoting the Decision of the CTA in the case of *Del Rosario Drug Corporation vs. Commissioner of Internal Revenue*, C.T.A. Case No. 5357, April 6, 1998.

[20] CTA Case No. 5357, April 6, 1998.

Under RR No. 2-94, respondent has interpreted tax credit as synonymous to tax deduction in glaring contradiction to the above definition. Undoubtedly, there is a clear distinction, nay, difference between the two terms.

Under these circumstances, the law should reign supreme over subordinate rules and regulations where the provisions of the latter are not in accord with the former. It is clearly provided in Section 4(a) of RA 7432 that the cost of the 20% discount granted by private establishments may be claimed by the latter as tax credit and not as a deduction contrary to what has been declared in Revenue Regulations No. 2-94. In case of conflict between a statute and an administrative order, the former must prevail. (Kilusang Mayo Uno vs. Garcia, Jr., 239 SCRA 386) Furthermore, the legal issue in this petition has already been settled in the case entitled Sto. Rosario Drug vs. Commissioner of Internal Revenue, CTA Case No. 5367, dated February 16, 1998.

In declaring that the provisions of RA 7432 prevail over Revenue Regulations No. 2-94, it is important to point out that the cost of the 20% discount shall not be treated as deduction from the gross income of the petitioner nor deducted from its gross sales for VAT or other percentage tax purposes. The benefit that can be derived by taxpayers is the privilege of claiming these discounts as tax credit and no longer as deductions as what other taxpayers have done. They cannot avail of tax credit and claim said discounts as deductions at the same time because this would be tantamount to granting them benefits that are already disproportionate to the obligations imposed upon them by virtue of said law. This is to make clear for both the taxpayers and respondent that the tax credit privilege takes the place of claiming these discounts as deductions pursuant to this Court's stand that Section 2(i) of Revenue Regulations No. 2-94 is null and void and it is Section 4(a) of RA 7432 that will apply in cases of this nature."

The Supreme Court agreed with the above ruling when it declared in ***Commissioner of Internal Revenue vs. Central Luzon Drug Corporation*** that:[21]

"**The 20 percent discount required by law to be given to senior citizens is a *tax credit***, not merely a *tax deduction* from the gross income or gross sale of the establishment Jr

[21] G.R. No. 159647, April 15, 2005.

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> concerned. A *tax credit* is used by a private establishment only after the tax has been computed; a *tax deduction*, before the tax is computed. **RA 7432 unconditionally grants a *tax credit* to all covered entities. Thus, the provisions of the revenue regulation that withdraw or modify such grants are void. Basic is the rule that administrative regulations cannot amend or revoke the law**." (*Emphasis supplied*)

In ***Commissioner of Internal Revenue vs. Bicolandia Drug Corporation (formerly known as Elmas Drug Co.)***[22], the Highest Tribunal ruled that Revenue Regulations No. 2-94 is void for its failure to conform to the law it sought to implement. Based on the foregoing, the 20% sales discounts granted to qualified senior citizens must be treated as tax credits pursuant to Republic Act 7432, not deductions from gross income as provided in Revenue Regulations 2-94.

It appears from the BIR Records that the assessment for deficiency income tax pertains to discounts given by the hospital to patients who are senior citizens; and the assessment for deficiency value-added tax pertains to pharmacy sales to in-patients.[23] Thus, this Court finds petitioner's appeal to be meritorious.

WHEREFORE, petitioner's Petition for Review is hereby **GRANTED**. Accordingly, the assessment for deficiency income and value-added taxes for the taxable year 2001 against petitioner is hereby **WITHDRAWN** and **CANCELLED.**

SO ORDERED.

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

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[22] G.R. No. 148083, July 21, 2006.
[23] BIR records, pp. 126-131.

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WE CONCUR:

ERLINDA P. UY
Associate Justice

OLGA PALANCA-ENRIQUEZ
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 case was assigned to the writer of the opinion of the Court.

ERNESTO D. ACOSTA
Presiding Justice