REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

XAVIER SCHOOL, INC.,
Petitioner,

versus CTA CASE NO. 1682

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

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DECISION

Petitioner appealed from the decision of respondent dated July 28, 1965 holding it liable for deficiency income tax for 1959, 1960 and 1962, in the aggregate amount of ₱134,052.41, computed as follows:

1959

Gain on sale of Echague property . .	₱896,029.47
Interest income	900.00
Net income per investigation	₱896,929.47
Tax due thereon	89,693.00
25% Surcharge	22,423.25
½% monthly interest from 7-16-59 to 7-16-62	16,144.74
Compromise for non-filing . . .	200.00
TOTAL AMOUNT DUE & COLLECTIBLE . . .	₱128,460.99

1960

Interest income received from Continental Oil Co.	₱ 21,459.82
Interest income received from Filipinas Investment Corporation .	3,798.35
Total	₱ 25,258.17

Less: Interest paid to Ayala & Co. . . . . ₱12,277.29		
Interest paid to Bank	6,144.99	₱ 18,422.28
Net income per investigation		6,835.89
Tax due thereon (10%)		684.00
25% surcharge		171.00
½% monthly interest from 7-16-60 to 7-15-63		123.12
Compromise for non-filing		40.00
TOTAL AMOUNT DUE & COLLECTIBLE		₱ 1,018.12

1962

Interest income received from Continental Oil Co.		₱ 41,501.66
Cash Dividend from Filipinas Investment Corp.		2,574.40
T o t a l		₱ 44,076.06
Less: Interest paid to Ayala & Co. . . .	₱2,941.63	
Interest paid to Bank . . .	2,333.75	
Interest paid to Society of Jesus	4,500.00	9,775.38
Net income per investigation		₱ 34,300.68
Tax due thereon		3,430.00
25% surcharge		857.50
½% monthly interest from 7-16-62 to 7-15-63 . . .		205.80
Compromise for non-filing.		80.00
TOTAL AMOUNT DUE & COLLECTIBLE.		₱ 4,573.30

Petitioner (formerly known as Kwang Chi School) is a duly organized private non-stock corporation for educational purposes. For school site purposes, petitioner purchased on December 15, 1955 from Candelaria Guidote and her co-owners several parcels of land located at Echague, Quiapo, Manila (hereinafter referred to as Echague property) in consideration of ₱778,475.00 payable on 32 quarterly installments plus interest of 6% per annum. Realizing that the

Echague property was inadequate and inappropriately situated to meet the expanding needs of an educational institution, petitioner by a letter dated April 17, 1958 sought permission from the Director of Private Schools to transfer its functions and activities to another site in the suburb of Manila.

On September 12, 1958, petitioner purchased from Ortigas and Company three (3) parcels of land located at San Juan, Rizal, for ₱421,392.00 (Exh. L, p. 87, CTA rec.). The money ($125,000.00 U.S. dollars) used by petitioner to purchase the new school lot (San Juan property), bearing interest of 4% per annum, was borrowed from the Jesuit Central Procure, Kowloon, Hongkong, with the agreement that the loan is payable as soon as the Echague property is sold (Exhs. H & H-1, pp. 79-80, CTA rec.).

On February 13, 1959, petitioner agreed to sell the Echague property to Continental Oil Co., Inc. for ₱1,840,403.18, <u>payable in 1959</u> as follows:

Paid as earnest money	₱ 50,000.00
Payable on or before Feb. 16, 1959..	761,390.00
Payable on or before May 15, 1959...	250,000.00
Payable on or before Aug. 15, 1959..	250,000.00
Payable on or before Nov. 15, 1959..	200,000.00
Payable after Nov. 15, 1959 with thirty days notice	329,013.18
T o t a l	₱1,840,403.18

The petitioner agreed to vacate the Echague property on or before October 31, 1959 and, if it fails to do so, it shall pay ₱2,000.00 monthly rental up to December 31, 1959 and a very much higher rental thereafter. No interest whatsoever was imposed on the unpaid installment payment. (Exh. D, CTA rec. pp. 56-57.)

By a Supplementary Agreement between the said parties dated December 26, 1959, there still remains out of the selling price of ₱1,840,403.18 a balance of ₱450,513.18 due petitioner. In addition to this sum there is still another amount due in the sum of ₱331,436.49 payment of which is secured by a mortgage over the Echague property. For the settlement of said obligation, Continental Oil Co., Inc., vendee, secured a loan of ₱500,000.00 from the Government Service Insurance System (GSIS) and applied the same for the partial settlement of the purchase price of the Echague property. The resulting balance of ₱281,949.49 was payable on or before February 15, 1960 with <u>interest at the rate of 8% per month</u> starting from January 1, 1960 until the said balance is paid. (Exh. E, CTA rec. pp. 61-63.) However, the said balance as of December 31, 1962, or a period of almost 3 years, has not been paid by Continental Oil Co., Inc.

For income tax purposes, the sale of the Echague property was considered by respondent as a cash sale in 1959 because 25% or more of the purchase price was paid by the vendee in that year. (See Sec. 43/b/ of the Tax Code.) Hence, the gain from the sale of the property in question was realized by petitioner in 1959.

It appears that from the proceeds of the sale petitioner deposited on March 18, 1959 the amount of ₱120,000.00 with the Estate of Go Chong Kang with interest of 9% per annum. (Vol. II, BIR rec. p. 95.) The depositary was later on organized into Filipinas Investment & Finance Corporation (hereinafter referred to as Filipinas). The said amount of ₱120,000.00 was deposited while the same was not allegedly needed in the construction of the San Juan property. By December of 1959, as the construction work progressed, the said deposit was reduced to ₱40,000.00 and it was left with Filipinas as a revolving fund for the retirement pay of petitioner's faculty members and other employees.

On September 23, 1961, Ortigas and Company sold to petitioner an additional parcel of land for ₱371,319.20, inclusive of ₱37,299.20 as interest thereon, but ₱167,160.00 was paid by it on said date and the balance of ₱204,459.20 was made payable in equal consecutive quarterly installments over a period of five (5) years beginning December 8, 1961 (Exh. M, CTA rec. pp. 91-94).

On July 15, 1963, respondent demanded from petitioner payment of the deficiency income taxes for 1959, 1960 and 1962 amounting to ₱134,052.41 which assessment was disputed by petitioner. (Exh. 9, pp. 84-85, Vol. I, BIR rec.) On July 28, 1965, respondent denied said protest and requested that the deficiency income tax assessments be paid (Exh. 11, pp. 111-113, Vol. I, BIR rec.). From the denial of its protest, petitioner appealed to this Court.

The principal issue to be resolved by this Court is whether or not petitioner is exempt from income tax under the provisions of Section 27(e) of the Tax Code on income derived from the following sources:

(a) Gain of ₱896,029.47 derived from the sale of Echague property in 1959;

(b) Interests of ₱21,459.82 and ₱41,501.66 earned in 1960 and 1962 on the unpaid balance of the selling price of said property due from Continental Oil Co., Inc.;

(c) Interests of ₱900.00 and ₱3,798.35 earned in 1959 and 1960 from the Estate of Go Chong Kang and Filipinas Investment & Finance Corp., respectively; and

(d) Cash dividend of ₱2,574.40 received from Filipinas Investment & Finance Corporation in 1962.

Petitioner contends that as a non-profit educational institution, it is exempt from income tax

tax under Section 27(e) of the Tax Code, which provides as follows:

> SEC. 27. Exemptions from tax on corporations.—The following organizations shall not be taxed under this Title in respect to income received by them as such—
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> 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; (Underscoring supplied.)

Respondent contends otherwise and claims that petitioner should be held liable on its income from sources listed above because the law provides 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 for the tax imposed under this Code," citing in support of his stand the case of Congregacion de la Mission de San Vicente de Paul decided by this Court on October 14, 1968. Respondent further claims that, since petitioner is invoking as a defense the statutory provisions for tax exemption, the law should be construed strictly against the taxpayer and liberally in favor of the taxing authority.

The case of Congregacion de la Mission de San Vicente de Paul v. Commissioner of Internal Revenue, CTA Case No. 1468, October 14, 1968, cited and relied upon by respondent as the basis of its assessment, is not applicable *in toto* to the instant case which rests on an entirely different factual setting and background. In the above-cited case, there is no dispute that petitioner invested its money in activities purely for profit which are not essential to or necessarily connected with its religious, charitable and educational pursuits.

The situation in the case before us is distinct and different. Petitioner's isolated sale of the Echague property and using the proceeds thereof to purchase lots for a new site and constructing improvements thereon in furtherance of its educational purposes cannot be considered as an activity conducted solely for profit because a single transaction of incidental character does not constitute engaging in business. Moreover, the San Juan property was not acquired for speculation or as an investment to be eventually sold for monetary gain.

It is undisputed that the gain of ₱896,029.47

from the sale of the Echague property was used to acquire another property in San Juan, Rizal, and for necessary improvements thereon. The replacement of the Echague property by the San Juan property, which requires a higher investment, is not an activity conducted for profit. As shown by the evidence (Exh. N-1, Vol. II of BIR rec., p. 178) petitioner, as of December 1961, actually spent ₱2,186,096.24 for the San Juan property which exceeds the ₱1,912,645.00 realized from the sale of the Echague property. The sale of the Echague property and the acquisition and improvement of the San Juan property are isolated and incidental transactions devoid of any profit motive. We hold, therefore, that the incidental gain from the sale of the Echague property and the replacement thereof by the more expensive San Juan property are covered by the statutory exemption prescribed by Section 27(e) of the Tax Code. Thus, it was held:

> "The test is whether the sale was made as an incident to the regular activities of the club, as here, or whether it was entered into in disregard of its purpose, for the purposes of profit? A single transaction of incidental character does not constitute engaging in business. Santee Club v. White, 87 F. 2d 5, 18 AFTR 709, reversing 13 F. Supp. 816, 17 AFTR 491. Whether the particular sale is an incidental sale depends upon the facts. GCM 19465, CB 1938-I, p. 172." (Par. 4398, PH Federal Taxes, 1955.)

After disposing of Item (a) relative to the gain of ₱896,029.47 from the sale of the Echague property, we are now confronted with Items (b), (c) and (d) consisting of ₱21,459.82 and ₱41,501.66 as interests earned by petitioner in 1960 and 1962 on the unpaid balance of the selling price of the Echague property due from Continental Oil Co., Inc.; the sums of ₱900.00 and ₱3,798.35 as interests earned in 1959 and 1960 on the deposits made by petitioner with the Estate of Go Chong Kang and Filipinas Investment and Finance Corp.; and the cash dividend of ₱2,574.40 received from Filipinas Investment and Finance Corp. in 1962.

Petitioner contends that the income from interests and cash dividend of its real and personal properties is exempt from income tax under Section 27(e) of the Tax Code, supra, because the destination of said income was in furtherance of its educational functions and activities when it purchased, improved and constructed buildings on the San Juan property.

Respondent maintains, however, that a private educational institution is not exempt from income tax on income derived from the productive use of its real and personal properties because the income from any activity conducted for profit regardless of the disposition made of such income is subject to income tax under Section 27(e) of the Tax Code, as amended by Section 5 of Republic Act No. 82, supra.

> 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:
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> > "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. 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. 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, '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. 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, inter alia, 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 exemption with respect to income realized (a) from the productive use of their real and personal properties e.g., rents, dividends, or interests — (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. . . . (C[illegible]gacion de la Mission de

San Vicente de Paul v. Comm. of Internal Revenue, CTA Case No. 1468, prom. Oct. 14, 1968.)

(A review of the evidences on record shows that the sum of $125,000.00 U.S. dollars, borrowed by petitioner from Central Jesuit Procure, Kowloon, Hongkong, bears interest of 4% per annum. The loan was used by petitioner in the purchase of the San Juan property on September 12, 1958 but the same shall be paid from the proceeds of the sale of the Echague property. Despite the sale of said property on February 13, 1959 where petitioner received from the buyer the initial amount of ₱500,000.00, no payment whatsoever was made to the Hongkong creditor because the money was allegedly needed for the improvement of the San Juan property (Exh. I-2, p. 82, CTA rec.). On March 18, 1959, however, petitioner deposited ₱120,000.00 with the Estate of Go Chong Kang with interest of 9% per annum, or a difference of 5% interest per annum from the lower rate of interest payable to the Hongkong creditor. This actuation is an indication that petitioner intended to make profit out of its investment or deposit of ₱120,000.00.)

(While the consideration of ₱1,840,403.18 for the sale of the Echague property was payable in 1958 under the terms of the Agreement to Sell (Exh.

D, pp. 56-57, CTA rec.), petitioner entered into a Supplementary Agreement dated December 26, 1959, whereby the unpaid balance of the sale was made payable on or before February 15, 1960 with interest at the rate of 8% per month until the said balance is paid. Petitioner did not press for the payment of the aforesaid balance on its due date because, as shown in the computation of the assessment for income tax, supra, petitioner realized interest income of P21,459.82 and P41,501.66 in 1960 and 1962, respectively, although it also paid interests amounting to P18,422.28 and P9,775.38 during the same years.

The indebtedness of petitioner with its Hongkong creditor, which was subject to 4% interest per annum, was payable in 1959 from the proceeds of the sale of the Echague property. Be that as it may, petitioner invested or deposited a portion of said proceeds with the Estate of Go Chong Kang and Filipinas at 9% interest per annum and it deferred the collection of unpaid balance of P281,949.49 due from the sale of the Echague property which is subject to 8% interest per month.

Under the facts and circumstances of this case, we are convinced that the interests and dividend realized by petitioner for a number of years were not incidental to its educational activities because even as late as 1962 it earned interest and dividend amounting to ₱44,076.06.

It is clear, therefore, that the interest income and cash dividend realized by petitioner in 1959, 1960 and 1962 were not realized in the pursuit of its educational objectives and, therefore, they are subject to income tax within the purview of Section 27(e) of the Tax Code, as amended by Section 5 of Republic Act No. 82.

There is, therefore, due and collectible from petitioner for the years 1959, 1960 and 1962 the aggregate amount of ₱13,224.99, computed as follows:

1959

Interest income	₱900.00
Tax due thereon (22%)	₱198.00
25% surcharge	49.85
½% monthly interest from 7-16-59 to 7-16-62	35.64
TOTAL AMOUNT DUE & COLLECTIBLE . .	₱283.49

1960

Interest income received from Continental Oil Co., Inc. . .		₱21,459.82
Interest income received from Filipinas Investment Corporation		3,798.35
Total		₱25,258.17
Less: Interest paid to:		
Ayala & Co. . .	₱12,277.29	
Bank . . .	6,144.99	18,422.28
Net income per investigation . .		₱ 6,835.89
Tax due thereon (22%)		1,504.00
25% surcharge		376.00
½% monthly interest from July 16, 1960 to July 16, 1963. .		270.72
TOTAL AMOUNT DUE & COLLECTIBLE . .		₱ 2,150.72

1962

Interest income received from Continental Oil Co., Inc. . . .		₱ 41,501.66
Cash Dividend from Filipinas Investment Corporation		2,574.40
T o t a l		₱ 44,076.06
Less: Interest paid to:		
Ayala & Co. .	₱2,941.63	
Bank	2,333.75	
Society of Jesus . .	4,500.00	9,775.38
Net income per investigation . . .		₱ 34,300.68
Tax due thereon (22%) . . .		7,546.00
25% surcharge		1,886.50
½% monthly interest from July 16, 1962 to July 16, 1965 . . .		1,358.28
TOTAL AMOUNT DUE & COLLECTIBLE . .		₱ 10,790.78

Under Section 24 of the National Internal Revenue Code, as amended by Republic Act No. 2343, a domestic corporation is subject to 22% tax on its net income which does not exceed ₱100,000.00 while a private educational institution is subject to 10% tax on its total net income. In the case of Congregacion de la Mission de San Vicente de Paul, supra, a corporation solely organized and operated for religious, charitable and educational purposes, respondent assessed said corporation for deficiency income tax in 1956 and 1957 at the rate of 20% tax on its total net income and not at the rate of 10% tax due from a private educational institution. In other words, the then prevailing rate of 20% tax was imposed by respondent on the net income derived from activities conducted for profit by a religious, charitable and educational corporation instead of the 10% tax on the said net income.

After upholding and affirming the decision of respondent in the case of Congregacion de la Mission de San Vicente de Paul, supra, we have thought it wise to impose the then prevailing corporate income tax rate of 22% in this case, instead of 10% only, because a private educational institution which deviates from its purely educational purposes and activities shall be treated like any private domestic corporation engaged in business for profit with respect to income derived therefrom. The protective mantle of income tax benefit or exemption cannot be extended to a private educational institution which chooses to descend from its high pedestal of tax preference or immunity to the level of an ordinary private corporation engaged in profitable undertaking or business.

WHEREFORE, the decision of respondent appealed from is modified. Petitioner is hereby ordered to pay respondent or any of his authorized collection agent the sum of ₱13,224.99 as income taxes, surcharges and interests for the years 1959, 1960 and 1962. If the said amount is not paid within thirty (30) days from the date this decision becomes final and executory, petitioner shall pay a surcharge of 5% and 1% monthly as delinquency interest on the income taxes due until fully paid, provided that the said delinquency interest of 1% a month shall not exceed a period of three (3) years, or 36%, in accordance with Section 51(e) of the Tax Code, as amended by Republic Act No. 2343. Without pronouncement as to costs.

SO ORDERED.

Quezon City, October 8, 1969.

Estanislao R. Alvarez
ESTANISLAO R. ALVAREZ
Associate Judge

I CONCUR:

Ramon L. Avanceña
RAMON L. AVANCEÑA
Associate Judge

Presiding Judge UMALI took no part.