REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*	**CTA EB NO. 823** (CTA Case No. 7857)
-versus-	Present: **Acosta,** P.J. **Castañeda, Jr. Bautista, Uy, Casanova, Palanca-Enriquez, Fabon-Victorino, Mindaro-Grulla,** and **Cotangco-Manalastas,** JJ.
ST. LUKE'S MEDICAL CENTER, INC., *Respondent.*	Promulgated: DEC 03 2012 3:10pm

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D E C I S I O N

COTANGCO-MANALASTAS, J.:

On appeal before the Court *En Banc* by way of a *Petition for Review*[1] filed on September 20, 2011 by petitioner Commissioner of the Bureau of Internal Revenue (BIR), pursuant to Section 18 of Republic Act No. 1125, as amended by Republic Act No. 9282 and

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[1] *Rollo*, pp. 7-21.

Republic Act No. 9503,[2] are the August 23, 2011 *Resolution*[3] and June 3, 2011 *Decision*[4] enunciated by the Second Division of this Court in CTA Case No. 7857 entitled *"St. Luke's Medical Center, Inc., vs. Commissioner of Internal Revenue".* Quoted hereunder are the dispositive portions of the assailed *Resolution* and *Decision*:

Resolution dated August 23, 2011:

> "**WHEREFORE,** premises considered, respondent's "**Motion for Reconsideration**" is hereby **DENIED** for lack of merit.
>
> **SO ORDERED.**"

Decision dated June 3, 2011:

> "**WHEREFORE,** premises considered, the Petition for Review is hereby **GRANTED**. Accordingly, Assessment Notice No. INC-07-000224, assessing petitioner for alleged deficiency income taxes for the taxable year 2007 is hereby **CANCELLED** and **SET ASIDE.**
>
> **SO ORDERED.**"

Petitioner prays of this Court to reverse and set aside the August 23, 2011 *Resolution* and June 3, 2011 *Decision* and to issue a new ruling ordering respondent St. Luke's Medical Center, Inc. (SLMCI) to pay the amount of P93,074,387.18 as deficiency income tax for taxable year 2007, plus 25% surcharge and 20% annual

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[2] Otherwise known as "An Act Expanding the Jurisdiction of the Court of Tax Appeals (CTA), Elevating its Rank to the Level of a Collegiate Court with Special Jurisdiction and Enlarging its Membership, Amending for the Purpose Certain Sections of Republic Act No. 1125, as amended, Otherwise Known as the Law Creating the Court of Tax Appeals, and for Other Purposes."
[3] *Rollo*, pp. 45-48.
[4] *Rollo*, pp. 23-44.

interest for late payment from 29 August 2008 (due date indicated in the Formal Letter of Demand) until fully paid pursuant to Sections 248 and 249 of the National Internal Revenue Code (NIRC) of 1997, as amended.

THE FACTS

The facts of the case, as narrated by the Second Division of this Court, are reproduced hereunder:

> "Petitioner is a non-stock, non-profit corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office address at St. Luke's Hospital, E. Rodriguez Blvd., Quezon City.
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> Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR) vested with authority to exercise the functions of said office, including, inter alia, the power to abate or cancel a tax liability when the tax or any portion thereof appears to be unjustly or excessively assessed. Respondent holds office at the BIR National Office Building, Diliman, Quezon City.
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> Petitioner received from respondent's Large Taxpayer's Service a Formal Letter of Demand dated July 21, 2008, together with Details of Discrepancies and Audit Result/Assessment Notice No. INC-07-000224 dated August 7, 2008, for alleged deficiency income tax for the taxable year 2007 amounting to P89,627,083.92.
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> On September 19, 2008, petitioner filed an administrative protest against the above-mentioned deficiency tax assessment, praying for its cancellation.
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> On November 28, 2008, petitioner received respondent's Final Decision on Disputed Assessment dated October 22, 2008. The Final Decision modified the Formal Letter of Demand, Details of Discrepancies and Audit

Result/Assessment Notice by increasing the alleged deficiency income tax for the year 2007 to P93,074,387.18.

Respondent's main reason for assessing petitioner for deficiency income tax was based on the finding that petitioner is allegedly a non-profit hospital that is liable to pay ten percent (10%) tax on its net income pursuant to Section 27 (B) of the National Internal Revenue Code (NIRC) of 1997.

Hence, petitioner filed the instant Petition for Review on December 23, 2008.

Respondent filed her Answer on February 6, 2009, as follows:

"5. Petitioner is subject to 10% income tax. Section 27 (B) of the NIRC of 1997 specifically provides that:

> 'SECTION 27. Rates of Income Tax on Domestic Corporations. —
>
> (B) Proprietary Education Institutions and Hospitals. — Proprietary educational institutions and hospitals which are nonprofit shall pay a tax of ten percent (10%) on their taxable income except those covered by Subsection (D) hereof: Provided, that if the gross income from unrelated trade, business or other activity exceeds fifty percent (50%) of the total gross income derived by such educational institutions or hospitals from all sources, the tax prescribed in Subsection (A) hereof shall be imposed on the entire taxable income. For purposes of this Subsection, the term 'unrelated trade, business or other activity' means any trade, business or other activity, the conduct of which is not substantially related to the exercise or performance by such educational institution or hospital of its primary purpose or function. A 'proprietary educational institution' is any private school maintained and administered by private individuals or groups with an issued permit to operate from the Department of Education, Culture and Sports (DECS), or the

> Commission on Higher Education (CHED), or the Technical Education and Skills Development Authority (TESDA), as the case may be, in accordance with existing laws and regulations.'

Crystal clear from the foregoing provision of law is the fact that non-profit hospitals are now liable to pay ten percent (10%) on their taxable income except those covered by Section (D) of the same Code. This is a new provision introduced by the legislature unmistakably intended to amend the exemption on non-profit hospitals that were previously categorized as non-stock, non-profit corporations under Section 26 of the NIRC of 1977, as amended.

The aforequoted provision should be distinguished from Section 30(E) of the NIRC of 1997 which provides:

> 'SECTION 30. 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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> xxx xxx xxx
>
> (E) Nonstock corporation or association organized and operated exclusively for religious, charitable, scientific, athletic, or cultural purposes, or for the rehabilitation of veterans, 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;
>
> xxx xxx xxx'

The basic difference between Section 27(B) and Section 30(E) is that the former particularly mentions non-profit hospitals, while the latter generally enumerates non-stock corporations organized and operated exclusively, among other things, for charitable purposes. Basic and axiomatic is the rule on statutory construction that the specific provision should always prevail over the general provision.

Moreover, Section 27(B) does not provide any prohibition in the allocation of its net income as distinguished from

Section 30(E) which requires that '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.' Although there is no explicit requirement for non-profit hospitals to allot a certain percentage of its net income for charitable purposes, Section 27(B) considers non-profit hospitals as ordinary corporations but subject to a preferential rate of 10%.

Petitioner's reliance on the alleged letter of exemption issued to it on 9 June 1990 stating among others that it falls within the purview of a corporation for purely charitable and social welfare purposes, and accordingly, it is exempt from the payment of income tax on income received by it as such organization is utterly misplaced. In light of the enactment of the NIRC of 1997 which took effect on 1 January 1998, the 1990 ruling being invoked by petitioner is deemed repealed by Section 27(B). Thus, petitioner, as non-profit hospital is now subject to the 10% tax on its taxable income.

6. The payment of surcharge is mandatory. It has been explained by the Supreme Court '. . . that it is mandatory to collect penalty and interest at the stated rate in case of delinquency. The intention of the law is to discourage delay in the payment of taxes due the Government and, in this sense, the penalty and interest are not penal but compensatory for the concomitant use of the funds by the taxpayer beyond the date when he is supposed to have paid them to the Government. . . .' (Philippine Refining Company vs. Court of Appeals, et al., G.R. No. 118794, 8 May 1996).

Although petitioner filed Annual Income Tax Returns for taxable year 2007, the said return was evidently deficient and false as it did not contain the income tax due for the said taxable year. Section 248 (B) categorically provides that 'in case of willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or in case a false or fraudulent return is willfully made, the penalty to be imposed shall be fifty percent (50%) of the tax or of the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud: . . . .'

7. All presumptions are in favor of the correctness of tax assessments. The good faith of tax assessors and the validity of their actions are presumed. They will be presumed to have taken into consideration all the facts to which their attention was called (CIR vs. Construction Resources of Asia, Inc. 145 SCRA 671). It is incumbent upon the taxpayer to prove the contrary (Mindanao Bus Company vs. CIR, 1 SCRA 538; CIR vs. Tuazon, Inc., 173 SCRA 397) and failure to do so shall vest legality on respondent's actions and assessments.

8. Failure to present proof of error in the assessment will justify judicial affirmation of said assessment (Delta Motors Co. vs. Commissioner, C.T.A. Case No. 3782, 21 May 1986; Commissioner of Internal Revenue vs. Court of Appeals, et al., G.R. Nos. 104151 and 105563, 10 March 1995)."

During trial, petitioner and respondent presented documentary and testimonial evidence in support of their respective claims and contentions.

On July 23, 2010, considering petitioner's Memorandum filed on July 21, 2010 and respondent's Memorandum filed on July 16, 2010, the case was deemed submitted for decision.

The issues are as follows:

"1. Whether Petitioner is a non-stock, non-profit corporation organized for charitable and social welfare purposes under section 30 (E) and (G) of the NIRC;

2. Whether Petitioner is subject to 10% income tax under Section 27(B) of the NIRC;

3. Whether Petitioner SLMC is liable for the surcharge and interest imposed by Respondent CIR; and

4. Whether Petitioner SLMC is liable for compromise penalties for alleged non-compliance with Section 248(A) of the NIRC as amended."

The foregoing issues can be summarized as —

"Whether petitioner is a non-stock, non-profit corporation organized for charitable and social welfare purposes under Section 30(E) and (G) of the NIRC or whether petitioner is subject to 10% income tax under Section 27(B) of the NIRC."'

In its *Decision*[5] promulgated on June 3, 2011, the Court in Division found merit in SLMCI's contentions and, thus, granted its petition for review. Accordingly, the Court in Division ordered the cancellation and setting aside of Assessment Notice No. INC-07-000224, assessing the petitioner therein, SLMCI (respondent herein), for alleged deficiency income taxes for the taxable year 2007.

The Court in Division denied in its *Resolution*[6] dated August 23, 2011 the Motion for Reconsideration filed by the respondent therein, Commissioner of the BIR (petitioner herein), for lack of merit.

Hence, the filing of the instant *Petition for Review*[7].

On October 4, 2011, the Court *En Banc* required respondent SLMCI to file its comment on the subject petition within ten (10) days from notice. Respondent SLMCI failed to file its comment within the period granted, thus, considering the issues and arguments proffered by the petitioner, this Court resolved to give due course to the *Petition* and ordered the parties to submit their respective memoranda[8].

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[5] *Supra*, Note 4.
[6] *Supra*, Note 3.
[7] *Supra*, Note 1.
[8] *Rollo*, pp. 57-58.

On December 2, 2011, petitioner filed a *Manifestation*[9] stating that she is adopting the subject *Petition for Review* filed on September 20, 2011 as her Memorandum in this case. Respondent SLMCI timely filed its *Memorandum*[10] on December 29, 2011. Considering the *Manifestation* of petitioner and the *Memorandum* of respondent, the instant *Petition for Review* was submitted for decision on January 18, 2012.

THE ISSUE/S

Petitioner interposed the following sole issue:

"WHETHER OR NOT THE SECOND DIVISION OF THE HONORABLE COURT ERRED IN RULING THAT RESPONDENT IS NOT SUBJECT TO TEN PERCENT (10%) INCOME TAX UNDER SECTION 27 (B) OF THE NATIONAL INTERNAL REVENUE CODE OF 1997 (NIRC OF 1997)."

Arguments of Petitioner[11]

Petitioner emphasizes that Section 27 (B) of the NIRC of 1997 imposes on non-profit hospitals a tax of 10% on their taxable income; this new provision was unmistakably intended to amend the exemption on non-profit hospitals that were previously categorized as

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[9] *Rollo*, pp. 59-61.
[10] *Rollo*, pp. 64-79.
[11] *Rollo*, pp. 13-18.

non-stock, non-profit corporations under Section 26 of the NIRC of 1977, as amended.

Further, petitioner argues that the above-mentioned provision should be distinguished from Section 30 (E) of the NIRC of 1997; the basic difference between Section 27 (B) and Section 30 (E) is that the former particularly mentions "proprietary hospitals which are non-profit", while the latter generally enumerates non-stock corporations organized and operated exclusively, among other things, for charitable purposes; it does not necessarily follow that when a hospital is non-stock, non-profit and operated exclusively for charitable purpose, it falls within the purview of Section 30 (E) of the NIRC of 1997; where there is a particular or special provision and a general provision in the same statute and the latter in its most comprehensive sense would overrule the former, the particular or special provision must be operative and the general provision must be taken to affect only the other parts of the statute to which it may properly apply.

Also, petitioner maintains that: respondent is not operating purely for charitable and social welfare purposes; respondent's operations indicate that it is established for profit and not solely for charitable or social welfare purposes as only 13% of its operations for 1998 were allocated to charitable purposes; respondent's witness Atty. Alfonso Ancheta categorically answered on cross-examination that only 10% of the operations of the hospital is allocated for charitable purposes.

Lastly, petitioner submits that all presumptions are in favor of the correctness of tax assessments; and failure to present proof of error in the assessment will justify judicial affirmation of said assessment.

Arguments of Respondent[12]

Respondent SLMCI opposes petitioner's allegations and posits that petitioner erroneously concluded that respondent is a proprietary non-profit hospital which is taxable under Section 27 (B) of the NIRC of 1997. Respondent maintains that: Section 27 (B) of the NIRC of 1997 imposes a 10% income tax on non-profit hospitals that are proprietary, but said provision does not state that the 10% income tax is imposed on non-stock, non-profit hospitals; non-stock, non-profit hospitals organized and operated as charitable and social welfare institutions are still exempt from income tax pursuant to Section 30 (E) and (G) of the NIRC of 1997; the legislative intent was to remove the tax exemption only of proprietary non-profit hospitals is evident from a comparison of Section 26 (c) of the 1977 NIRC and Section 30 (E) of the NIRC of 1997; Section 26 (c) of the 1977 NIRC speaks of "corporation or association" in general terms intended to apply to both stock and non-stock corporations or associations that are non-profit; when said section was re-enacted as Section 30 (E) of the NIRC of 1997, the exemption from tax was no longer extended to any non-profit corporation or association, the exemption from income tax

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[12] *Rollo*, pp. 68-77.

under Section 30 (E) of the NIRC of 1997 is now limited to non-stock corporations that are non-profit; and that petitioners insistence that respondent is taxable under Section 27 (B) of the NIRC of 1997 would therefore expand the coverage of the provision beyond what the law clearly and expressly states, *i.e.*, that only proprietary, non-profit hospitals are subject to the 10% income tax.

Further, respondent avers that this Court has already ruled in cases involving the same issue that respondent is not a proprietary, non-profit hospital taxable under Section 27 (B) of the NIRC of 1997, but is a non-stock, non-profit corporation organized for charitable and social welfare purposes that is exempt from income tax under Section 30 (E) and (G) of the NIRC of 1997.

For its final point, respondent argues that it has shown by overwhelming preponderance of evidence that it is a charitable and social welfare institution, and that no part of its income or assets belong or inure to any member, organizer, officer, trustee or any specific person. Respondent contends that the transcript of stenographic notes of the testimony of Atty. Ancheta will readily show that what he actually said was that "at least" 10% of respondent's operations are allocated to charitable purposes; that the testimony of Atty. Ancheta was not given in the instant case but in another case docketed as CTA Case No. 6993 involving the same parties but of a different taxable year.

THE RULING OF THE COURT *EN BANC*

In this case, petitioner contends that respondent SLMCI, as a proprietary non-profit hospital, is liable to pay the income tax rate of 10% on its taxable income under Section 27 (B) of the NIRC of 1997; and argues that this new provision was unmistakably intended to amend the exemption that non-profit hospitals previously enjoyed as non-stock, non-profit corporations under Section 26 of the NIRC of 1977, as amended.

Section 27 (B) of the NIRC of 1997 states that:

> "SEC. 27. Rates of Income Tax on Domestic Corporations. –
>
> xxx xxx xxx
>
> "(B) *Proprietary Educational Institutions and Hospitals.* - Proprietary educational institutions and hospitals which are non-profit shall pay a tax of ten percent (10%) on their taxable income except those covered by Subsection (D) hereof: Provided, That if the gross income from unrelated trade, business or other activity exceeds fifty percent (50%) of the total gross income derived by such educational institutions or hospitals from all sources, the tax prescribed in Subsection (A) hereof shall be imposed on the entire taxable income. For purposes of this Subsection, the term '**unrelated trade, business or other activity**' means any trade, business or other activity, the conduct of which is not substantially related to the exercise or performance by such educational institution or hospital of its primary purpose or function. A '**proprietary educational institution**' is any private school maintained and administered by private individuals or groups with an issued permit to operate from the Department of Education, Culture and Sports (DECS), or the Commission on Higher Education (CHED), or the Technical Education and Skills Development Authority (TESDA), as the case may be, in accordance with existing laws and regulations." (Underscoring supplied)

Respondent, on the other hand, claims that it is a non-stock, non-profit corporation organized for charitable and social welfare purposes that is exempt from income tax under Section 30 (E) and (G) of the NIRC of 1997; and contents that Section 27 (B) of the NIRC of 1997 imposes a 10% income tax on non-profit hospitals that are proprietary, but said provision does not state that the 10% income tax is imposed on non-stock, non-profit hospitals like SLMCI.

Pertinent portions of Section 30 (E) and (G) of the NIRC of 1997 provide:

> **"SEC. 30. Exemptions from Tax on Corporations.** - The following organizations shall not be taxed under this Title in respect to income received by them as such:
>
> Xxx
>
> "(E) **Nonstock** corporation or association **organized** and **operated exclusively for** religious, **charitable**, scientific, athletic, or cultural purposes, or for the rehabilitation of veterans**, no part of its net income or asset shall belong to or inures to the benefit of any member, organizer, officer or any specific person**;
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> xxx
>
> "(G) Civic league or organization not organized for profit but operated exclusively for the promotion of social welfare;
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> xxx
>
> "Notwithstanding the provisions in the preceding paragraphs, **the income of whatever kind and character of the foregoing organizations from** any of their properties, real or personal, or **from any of their activities conducted for profit regardless of the disposition made of such income, shall be subject to tax imposed under this Code.**" (Emphasis supplied)

After due consideration of the arguments of both parties, the laws and recent jurisprudence relevant to the case at bar, *We* are inclined to partially grant the *Petition for Review* of the Commissioner of BIR.

In the disposition of this present controversy, apart from the express provisions of Section 27 (B) and Section 30 (E) and (G) of the NIRC of 1997, as amended, the Court *En Banc* takes its bearing from the recent pronouncement of the Supreme Court in the case of *Commissioner of Internal Revenue vs. St. Luke's Medical Center, Inc.*,[13] -- considering that "[t]he Supreme Court by tradition and in our system of judicial administration, has the last word on what the law is; it is the final arbiter of any justifiable controversy"[14]. In the said case, the High Court clarified the lingering issues/questions, *i.e.*, issues as to the imposition of the income tax rate of 10% on the taxable income of proprietary non-profit hospitals under Section 27 (B); the income tax exemptions of proprietary non-profit hospitals under Section 30 (E) and (G) of the NIRC of 1997, as amended; and the questions as to when a proprietary non-profit hospital subject to the income tax rate of 10% on its taxable income?; and when is it considered exempt from income tax?

First, the Supreme Court described the rate of tax imposed under Section 27 (B), the qualifications of hospitals in order for the said rate to apply, the effect of the introduction of the aforesaid section, and likewise explained that Section 27 (B) and Section 30 (E) and (G) of the NIRC of 1997 can be construed together without the removal of such tax exemption under the latter provision, *i.e.*, a proprietary non-profit hospital whose income **from activities**

[13] G.R. No. 195909 and 195960, September 26, 2012.
[14] *Commissioner of Internal Revenue (CIR) vs. Michel J. Lhuiller*, G.R. No. 150947, July 15, 2003.

conducted for profit is subjected to the 10% tax rate under Section 27 (B) may still retain its tax exempt status under Section 30 (E) and (G) for its **not-for-profit activities**, *thus*:

> "The Court partly grants the petition of the BIR but on a different ground. We hold that Section 27(B) of the NIRC does not remove the income tax exemption of proprietary non-profit hospitals under Section 30(E) and (G). Section 27(B) on one hand, and Section 30(E) and (G) on the other hand, can be construed together without the removal of such tax exemption. The effect of the introduction of Section 27(B) is to subject the taxable income of two specific institutions, namely, proprietary non-profit educational institutions and proprietary non-profit hospitals, among the institutions covered by Section 30, to the 10% preferential rate under Section 27(B) instead of the ordinary 30% corporate rate under the last paragraph of Section 30 in relation to Section 27(A) (1).
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> "Section 27(B) of the NIRC imposes a 10% preferential tax rate on the income of (1) proprietary non-profit educational institutions and (2) proprietary non-profit hospitals. The only qualifications for hospitals are that they must be proprietary and non-profit. "Proprietary" means private, following the definition of a "proprietary educational institution" as "any **private** school maintained and administered by **private** individuals or groups" with a government permit. "Non-profit" means no net income or asset accrues to or benefits any member or specific person, with all the net income or asset devoted to the institution's purposes and all its activities." (Underscoring supplied)

Second, the High Court discussed Section 30 (E) and (G) of the NIRC of 1997, as amended, (*the provision under which the respondent SLMCI is claiming income tax exemption*) by enumerating the essential requisites in order for the income received by a charitable corporation or association to be considered exempt from income tax. The discussion highlights the High Court's pronouncement that "*[t]o be exempt from income taxes, Section 30(E) of the NIRC requires that a charitable institution must be* ***"organized and operated exclusively"*** *for charitable purposes. Likewise, to be exempt from income taxes, Section 30(G) of the NIRC requires that the institution be operated exclusively" for social welfare." viz*:

> "Section 30(E) of the NIRC provides that a charitable institution must be:
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> (1) A non-stock corporation or association;
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> (2) **Organized exclusively** for charitable purposes;
>
> (3) **Operated exclusively** for charitable purposes; and
>
> (4) 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.
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> "Thus, both the organization and operations of the charitable institution must be devoted "**exclusively**" for charitable purposes. The organization of the institution refers to its corporate form, as shown by its articles of incorporation, by-laws and other constitutive documents. Section 30(E) of the NIRC specifically requires that the corporation or association be non-stock, which is defined by the Corporation Code as "one where no part of its income is distributable as dividends to its members, trustees, or officers" and that any profit "obtain[ed] as an incident to its operations shall, whenever necessary or proper, be used for the furtherance of the purpose or purposes for which the corporation was organized." However, under *Lung Center*, any profit by a charitable institution must not only be plowed back "whenever necessary or proper," but must be "devoted or used **altogether** to the charitable object which it is intended to achieve."
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> "The operations of the charitable institution generally refer to its regular activities. Section 30(E) of the NIRC requires that these operations be **exclusive** to charity. There is also a specific requirement that "no part of [the] net income or asset shall belong to or inure to the benefit of any member, organizer, officer or any specific person." The use of lands, buildings and improvements of the institution is but a part of its operations.
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> "There is no dispute that St. Luke's is organized as a non-stock and non-profit charitable institution. However, this does not automatically exempt St. Luke's from paying taxes. This only refers to the organization of St. Luke's. Even if St. Luke's meets the test of charity, a charitable institution is not *ipso facto* tax exempt. To be exempt from real property taxes, Section 28(3), Article VI of the Constitution requires that a

> charitable institution use the property "actually, directly and exclusively" for charitable purposes. To be exempt from income taxes, Section 30(E) of the NIRC requires that a charitable institution must be "**organized and operated exclusively**" for charitable purposes. Likewise, to be exempt from income taxes, Section 30(G) of the NIRC requires that the institution be operated exclusively" for social welfare."

Following the foregoing discussion, the Supreme Court keenly steered the discussion to the last paragraph of Section 30 of the NIRC and stressed its point that this last paragraph qualifies the words "organized and operated exclusively" by providing that "*income of whatever kind and character of the foregoing organizations xxx xxx from* ***any of their activities conducted for profit regardless of the disposition made of such income, shall be subject to tax imposed under this Code***." Simply put, even if the charitable institution must be "**organized and operated exclusively**" for charitable purposes, it is still allowed to engage in "**activities conducted for profit**" without losing its tax exempt status for its **not-for-profit activities**. The only consequence is that the **"income of whatever kind and character"** of a charitable institution "**from any of its activities conducted for profit, regardless of the disposition made of such income, shall be subject to tax.**", *viz*:

> "However, the last paragraph of Section 30 of the NIRC qualifies the words "organized and operated exclusively" by providing that: Notwithstanding the provisions in the preceding paragraphs, the income of whatever kind and character of the foregoing organizations from any of their properties, real or personal, or from ***any of their activities conducted for profit* regardless of the disposition made of such income, shall be subject to tax imposed under this Code**.
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> "In short, the last paragraph of Section 30 provides that if a tax exempt charitable institution conducts **"any"** activity for profit, such activity is not tax exempt even as its not-for-

> profit activities remain tax exempt. This paragraph qualifies the requirements in Section 30(E) that the "[n]on-stock corporation or association [must be] **organized and operated exclusively** for x x x charitable x x x purposes x x x." It likewise qualifies the requirement in Section 30(G) that the civic organization must be "operated exclusively" for the promotion of social welfare.
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> "Thus, even if the charitable institution must be "organized and operated exclusively" for charitable purposes, it is nevertheless allowed to engage in "activities conducted for profit" without losing its tax exempt status for its not-for-profit activities. The only consequence is that the **"income of whatever kind and character"** of a charitable institution **"from any of its activities conducted for profit, regardless of the disposition made of such income, shall be subject to tax."** Prior to the introduction of Section 27(B), the tax rate on such income from for-profit activities was the ordinary corporate rate under Section 27(A). With the introduction of Section 27(B), the tax rate is now 10%." (Underscoring supplied)

Finally, consistent with the above-discussion, the Supreme Court ruled that St. Luke's is a corporation that is not "**operated exclusively**" for charitable or social welfare purposes insofar as its revenues from paying patients are concerned. The Supreme Court declared that the P1.73 billion from paying patients are income received from "**activities conducted for profit**". The Supreme Court explained, *thus*:

> "In 1998, St. Luke's had total revenues of P1,730,367,965 from services to **paying** patients. It cannot be disputed that a hospital which receives approximately P1.73 billion from **paying** patients is **not** an institution "operated exclusively" for charitable purposes. Clearly, revenues from **paying** patients are income received from "activities conducted for profit." xxx.
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> xxx xxx xxx
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> "In *Lung Center*, this Court declared:
>
> > "[e]xclusive" is defined as possessed and enjoyed to the exclusion of others; debarred from participation or enjoyment; and "exclusively" is defined, "in a manner to exclude; as enjoying a privilege exclusively." x x x

> The words "dominant use" or "principal use" cannot be substituted for the words "used exclusively" without doing violence to the Constitution and the law. **Solely is synonymous with exclusively.**

"The Court cannot expand the meaning of the words "operated exclusively" without violating the NIRC. **Services to paying patients are activities conducted for profit. They cannot be considered any other way. There is a "purpose to make profit over and above the cost" of services.** The P1.73 billion total revenues from paying patients is not even incidental to St. Luke's charity expenditure of P218,187,498 for non-paying patients.

"St. Luke's claims that its charity expenditure of P218,187,498 is 65.20% of its operating income in 1998. However, if a part of the remaining 34.80% of the operating income is reinvested in property, equipment or facilities used for services to **paying and non-paying** patients, then it cannot be said that the income is "devoted or used **altogether** to the charitable object which it is intended to achieve." The income is plowed back to the corporation not entirely for charitable purposes, but for profit as well. In any case, the last paragraph of Section 30 of the NIRC expressly qualifies that income from activities for profit is taxable **"regardless of the disposition made of such income."**

xxx xxx xxx

"The question was whether having a hospital is essential to an educational institution like the College of Medicine of the University of Santo Tomas. Senator Cuenco answered that if the hospital has paid rooms generally occupied by people of good economic standing, then it should be subject to income tax. He said that this was one of the reasons Congress inserted the phrase "or any activity conducted for profit."

"The question in *Jesus Sacred Heart College* involves an educational institution. However, it is applicable to charitable institutions because Senator Cuenco's response shows an intent to focus on the activities of charitable institutions. Activities for profit should not escape the reach of taxation. Being a non-stock and non-profit corporation does not, by this reason alone, completely exempt an institution from tax. An institution cannot use its corporate form to prevent its profitable activities from being taxed.

"The Court finds that St. Luke's is a corporation that is **not** "operated exclusively" for charitable or social welfare purposes insofar as its revenues from paying patients are concerned. This ruling is based not only on a strict interpretation of a provision granting tax exemption, but also on the clear and plain text of Section 30(E) and (G). Section 30(E) and (G) of the

> NIRC requires that an institution be "**operated exclusively**" for charitable or social welfare purposes to be **completely** exempt from income tax. An institution under Section 30(E) or (G) does not lose its tax exemption if it earns income from its for-profit activities. Such income from for-profit activities, under the last paragraph of Section 30, is merely subject to income tax, previously at the ordinary corporate rate but now at the preferential 10% rate pursuant to Section 27(B).
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> xxx xxx xxx
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> "St. Luke's fails to meet the requirements under Section 30(E) and (G) of the NIRC to be completely tax exempt from all its income. However, it remains a proprietary non-profit hospital under Section 27(B) of the NIRC as long as it does not distribute any of its profits to its members and such profits are reinvested pursuant to its corporate purposes. St. Luke's, as a proprietary non-profit hospital, is entitled to the preferential tax rate of 10% on its net income from its for-profit activities." (Underscoring supplied)

Conspicuously, the present case fits perfectly into the mold of the above-quoted case entitled *Commissioner of Internal Revenue vs. St. Luke's Medical Center, Inc.,* G.R. No. 195909 and 195960, September 26, 2012. The facts in the instant case, the issue, and laws applicable, and even the parties involved are substantially similar to those of G.R. No. 195909. Thus, applying the foregoing principles laid down by the Supreme Court in G.R. No. 195909 to the instant case, the inescapable conclusion is that respondent SLMCI is liable for deficiency income tax in 2007 under Section 27 (B) of the NIRC of 1997, as amended.

As cited, before a corporation or association may be exempt from income tax under Section 30 (E) and (G) of the NIRC of 1997, as amended, following requisites must be satisfied:

(1) A non-stock corporation or association;

(2) **Organized exclusively** for charitable purposes;

(3) **Operated exclusively** for charitable purposes; and

(4) 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.

As regards the first, second, and fourth requisite, this Court agrees with the Court in Division in finding that respondent SLMCI sufficiently satisfied these requisites. SLMCI is a **non-stock**, non-profit corporation **organized** for charitable and social welfare purposes as indicated in its Amended Articles of Incorporation; and on the basis of a judicial affidavit, which was not contested by the petitioner, attesting that **no part of SLMCI's income or net asset inures to the benefit of any trustee**, respondent SLMCI is deemed to have satisfied the fourth requisite.

It is the third requisite which respondent SLMCI utterly failed to satisfy. In line with the above-mentioned jurisprudential precepts enunciated in G.R. No. 195909[15], and based on the explicit provisions of Section 30 (E) and (G) of the NIRC of 1997, as amended, and also on the strict interpretation of a provision granting tax exemption, the Court holds that respondent SLMCI is **not** "operated exclusively" for charitable or social welfare purposes insofar as its revenues from paying patients are concerned. The Supreme Court expressed that "'Services to paying patients are activities conducted for profit. They

[15] *Commissioner of Internal Revenue vs. St. Luke's Medical Center, Inc.*, G.R. No. 195909 and 195960, September 26, 2012.

cannot be considered any other way. There is a "purpose to make profit over and above the cost" of services."'

Records show that respondent SLMCI declared the amount of P4,680,298,231 as "Revenue from Services to Patients", the expenditure of P511,843,073 as "Free Services", and the amount of P753,166,477 as "Excess of Revenue Over Expenses". The contrasting difference between the sizeable amount of revenues received by SLMCI from paying patients of approximately P4.6 billion and the amount allotted by SLMCI to "Free Services" which is roughly P5.1 million, further buttress the finding that respondent SLMCI is **not** an institution "operated exclusively" for charitable purposes. The Supreme Court stressed in G.R. No. 195909[16] that the operations of the charitable institution generally refer to its regular activities and Section 30 (E) requires that these operations be **exclusive** to charity. In the case of *Lung Center of the Philippines vs. Quezon City*[17], the Supreme Court expounded on the meaning of **exclusive**:

> "[e]xclusive" is defined as possessed and enjoyed to the exclusion of others; debarred from participation or enjoyment; and "exclusively" is defined, "in a manner to exclude; as enjoying a privilege exclusively." x x x The words "dominant use" or "principal use" cannot be substituted for the words "used exclusively" without doing violence to the Constitution and the law. **Solely is synonymous with exclusively.**

Hence, if a part of the remaining P7.5 million ("Excess of Revenue Over Expenses") "'is reinvested in property, equipment, or

[16] *Supra,* Note 15.
[17] G.R. No. 144104, June 29, 2004.

facilities used for services to **paying and non-paying** patients, then it cannot be said that the income is "devoted or used **altogether** to the charitable object which it is intended to achieve". The income is plowed back to the corporation not entirely for charitable purposes, but for profit as well."'[18]

In support of the above finding, *We* reiterate the ratiocination of the Supreme Court in G.R. No. 195909[19]:

> "In 1998, St. Luke's had total revenues of P1,730,367,965 from services to **paying** patients. It cannot be disputed that a hospital which receives approximately P1.73 billion from **paying** patients is **not** an institution "operated exclusively" for charitable purposes. Clearly, revenues from **paying** patients are income received from "activities conducted for profit." xxx.
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> xxx xxx xxx
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> "In *Lung Center*, this Court declared:
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>> "[e]xclusive" is defined as possessed and enjoyed to the exclusion of others; debarred from participation or enjoyment; and "exclusively" is defined, "in a manner to exclude; as enjoying a privilege exclusively." x x x The words "dominant use" or "principal use" cannot be substituted for the words "used exclusively" without doing violence to the Constitution and the law. **Solely is synonymous with exclusively.**
>
> "The Court cannot expand the meaning of the words "operated exclusively" without violating the NIRC. **Services to paying patients are activities conducted for profit. They cannot be considered any other way. There is a "purpose to make profit over and above the cost" of services.** The P1.73 billion total revenues from paying patients is not even incidental to St. Luke's charity expenditure of P218,187,498 for non-paying patients.
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> "St. Luke's claims that its charity expenditure of P218,187,498 is 65.20% of its operating income in 1998. However, if a part of the remaining 34.80% of the operating income is reinvested in property, equipment or facilities used for services to **paying**

[18] *Commissioner of Internal Revenue vs. St. Luke's Medical Center, Inc.*, G.R. No. 195909 and 195960, September 26, 2012 citing *Lung Center of the Philippines vs. Quezon City*, G.R. No. 144104, June 29, 2004.
[19] *Supra*, Note 15.

> **and non-paying** patients, then it cannot be said that the income is "devoted or used **altogether** to the charitable object which it is intended to achieve." The income is plowed back to the corporation not entirely for charitable purposes, but for profit as well. In any case, the last paragraph of Section 30 of the NIRC expressly qualifies that income from activities for profit is taxable **"regardless of the disposition made of such income."**
>
> **xxx xxx xxx"**

Nevertheless, even if this Court rules that respondent is an institution "**operated exclusively**" for charitable purpose, respondent may still be held liable for deficiency income tax under of the last paragraph of Section 30 of the NIRC of 1997, as amended. The last paragraph of Section 30 provides that if an institution, considered as tax exempt under Section 30 (E) and (G), conducts "**any"** activity for profit, the income from such activity is not tax exempt regardless of the disposition made of such income and even as its not-for-profit activities remain tax exempt. It bears to stress, however, that "[a]n institution under Section 30(E) or (G) does not lose its tax exemption if it earns income from its for-profit activities. Such income from for-profit activities, under the last paragraph of Section 30, is merely subject to income tax, previously at the ordinary corporate rate but now at the preferential 10% rate pursuant to Section 27(B)."[20]

As held by the Supreme Court, "revenues from **paying** patients are income received from "activities conducted for profit."[21] Thus, in this case, albeit we consider respondent SLMCI an institution

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[20] *Supra,* Note 15.
[21] *Supra.*

"operated exclusively" for charitable purposes, its revenues received from paying patients are regarded as income from "**activities conducted for profit**" and therefore subject to tax under the Tax Code regardless of the disposition made of such income. "Prior to the introduction of Section 27(B), the tax rate on such income from for-profit activities was the ordinary corporate rate under Section 27(A). With the introduction of Section 27(B), the tax rate is now 10%."[22]

Respondent failed to meet all the requirements under Section 30 (E) and (G) of the NIRC of 1997, as amended, to be **completely** tax exempt from all its income. Nonetheless, considering that it remains a proprietary non-profit hospital under Section 27 (B) of the NIRC of 1997 as long as it does not distribute any of its profits to its members and such profits are reinvested pursuant to its corporate purposes, respondent SLMCI is entitled to the preferential tax rate of 10% on its net income from its "activities conducted for profit".[23]

Finally, as regards the interest and surcharges, the Court finds that respondent SLMCI has adequate reasons to rely on the letter dated June 6, 1990 by the BIR, which declared that respondent is "a corporation for purely charitable and social welfare purposes". Hence, there is sufficient justification to delete the imposition of surcharges and interest. This is in keeping with the ruling of the Supreme Court in G.R. No. 195909[24], *viz:*

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[22] *Supra,* Note 15.
[23] *Supra.*
[24] *Supra.*

> "St. Luke's is therefore liable for deficiency income tax in 1998 under Section 27(B) of the NIRC. However, St. Luke's has good reasons to rely on the letter dated 6 June 1990 by the BIR, which opined that St. Luke's is "a corporation for *purely* charitable and social welfare purposes" and thus exempt from income tax. In *Michael J. Lhuillier, Inc. v. Commissioner of Internal Revenue*, the Court said 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."

WHEREFORE, premises considered, the Petition for Review is hereby **PARTIALLY GRANTED**. The Decision of the Second Division of this Court dated June 3, 2011 and its Resolution dated August 23, 2011 in CTA Case No. 7857 are **MODIFIED**. Respondent St. Luke's Medical Center, Inc. is **ORDERED TO PAY** the deficiency income tax in 2007 based on the 10% preferential income tax rate under Section 27(B) of the NIRC of 1997, as amended. However, it is not liable for surcharges and interest on such deficiency income tax under Sections 248 and 249 of the NIRC of 1997, as amended.

SO ORDERED.

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

(On Leave)
OLGA PALANCA-ENRIQUEZ
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation with the members of the Court *En Banc* before the case was assigned to the writer of the opinion of the Court.

ERNESTO D. ACOSTA
Presiding Justice