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MANILA POLO CLUB,
Petitioner,

- versus -

C.T.A.
CASE NO. 293

August 31, 1959

COLLECTOR OF INTERNAL
REVENUE,
Respondent.

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D E C I S I O N

On January 12, 1955, the respondent assessed against the petitioner the sums of ₱262,635.42 and ₱70,547.82 as income tax for the years 1947 and 1948, respectively, on the income realized by the latter from the sales of its real property situated in Pasay City, computed as follows:

1947

Sale to U.S. Government -----	₱1,490,360.00
Less value of property sold--	31,274.34
Capital gain ---------------	₱1,459,085.66
Tax due at 12% ------------	₱ 175,090.28
50% surcharge -------------	87,545.14
Total -------------------	₱ 262,635.42

1948

Sale to Manila Yellow Taxicab Co. -------------	₱ 400,000.00
Less value of property sold -	8,067.70
Capital gain -------------	₱ 391,932.30
Tax due at 12% -----------	₱ 47,031.88
50% surcharge -----------	23,515.94
Total -------------------	₱ 70,547.82

Petitioner sought a reconsideration of the assessment alleging that it is a social club which is exempt from income tax under Section 27(h) of the National Internal Revenue Code; that it was forced to sell a portion of its real property to the U.S. Army, which had previously occupied it incident to its operations in the Philippines; that a portion consisting of 20,000 square meters was donated to the Philippine Government; that the rest consisting of 20,800 square meters was sold to the Manila Yellow Taxicab Co., the same not being sufficient for its club activities; and that no part of the proceeds of the sales of said property inured to the benefit of any of its members, the same having been used exclusively to acquire and develop another property in Makati (Forbes Park) for the purposes for which the club was organized. Petitioner also alleged that the computation of the tax is erroneous because the value of certain improvements and expenses incident to the sales were not taken into account in determining the profit realized from the transactions. The request for reconsideration was denied on the following grounds:

> "(1) That the Manila Polo Club, Inc. is an athletic club within the purview of Section 27(e) of the Tax Code because its primary purpose, as clearly shown in its by-laws, is to promote the game of polo, other athletic sports and outdoor recreations;
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> "(2) That the purpose to promote social intercourse is just incidental to the aforesaid primary purpose, as clearly stated in the trust agreement between the corporation and the transferors of the lots in question;
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> "(3) That even if we were to concede that the corporation has also been organized for purposes stated in Section 27(h) and is therefore both an athletic and a social club, the income in question should nonetheless be considered the income of an athletic club because said income was derived from sales of lots dedicated to athle-

tic purposes; in other words, the income in question was earned by the corporation in its capacity as an athletic club; and

"(4) That even if the corporation were to be considered a social club, nevertheless, it is liable for the payment of income tax on profits realized from sales of its properties because, pursuant to the opening statement of Section 27 of the Tax Code, the tax exemption granted to organizations therein enumerated refers only to those income received by them as such; and the income received by them as such are membership fees and dues, and the like, and earnings derived from activities which are essentially and peculiarly the activities of the organization claiming exemption. In the case of social clubs, for example, the income received by them as such consists of fees and dues paid by club members and earnings from social club activities. Certainly, it cannot be claimed that the selling of real property is essentially and peculiarly an activity or function of a social club. When a social club sells its property, it does so in the exercise of its ownership over the property, but not in the exercise of any function which may be considered essentially and peculiarly that of a social club.

x x x

"Please be further advised that the case of your client was reinvestigated for the purpose of ascertaining the acquisition cost of the lots in question and the expenses allegedly incurred in connection with the sales of said lots. Our agents, however, reported that the manager of your client did not even try to prove said expenses. They further reported that, contrary to the allegation of your client, the corporation did not construct a building on the lot sold to the Manila Yellow Taxicab Company. And as for the acquisition cost of the estate which consisted of the lots in question, it appears that the records of your client do not show for how much the estate was acquired and that the book value thereof on October 31, 1953, in the amount of ₱47,099.56, appears to be the most approximate to said cost. The claim of your client that the amount of ₱64,210.37 should be considered the book value of the estate has no basis whatsoever. Its records clearly show that the book value of the estate on the date nearest to the date of acquisition thereof amounted to ₱47,099.56 only." (See Exhs. 1 and 5, pp. 168-169, BIR records.)

Having failed to secure a reconsideration of the decision of respondent, petitioner has appealed to this Court. The following issues have been raised in this appeal:

(1) Whether or not petitioner is a social club under Section 27(h) of the Revenue Code, as contended by petitioner, or an athletic Club under paragraph (e) of said section, as contended by respondent;

(2) Whether or not petitioner, as a social club or an athletic club, is subject to the income tax on the gain derived by it from the sales of its Pasay property;

(3) Whether or not the fraud penalty of 50% has been properly imposed; and

(4) Whether or not the income tax in the sums of ₱262,635.42 and ₱70,547.82, as computed by respondent, is correct.

After the filing of respondent's answer, but before trial, petitioner filed an urgent motion praying that judgment be rendered "holding that no income tax is due from the petitioner for the years 1947 and and 1948 on the ground that the right of the respondent to assess and collect the alleged income taxes from the petitioner for the said years has already prescribed under the provisions of Section 51(d) of the National Internal Revenue Code." The motion was denied in our resolution of April 1, 1957, this Court holding -

" . . . that Section 51(d) is a limitation solely upon the power of the Collector of Internal Revenue to enforce collection of income taxes by the summary remedy of distraint and levy (Sections 316-330, National Int. Rev. Code) and not upon the power to collect said taxes by judicial action. In this case, respondent has not

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made any attempt to enforce collection of the income tax assessed against petitioner by distraint and levy. Accordingly, Section 51(d) of the Revenue Code does not apply."

The motion for reconsideration filed by petitioner was denied on May 10, 1957.

We will now consider the case on the merits. The first issue relates to the classification of petitioner as an exempt organization under Section 27 of the Revenue Code - whether it is an athletic club, as contended by respondent, or a social club, as alleged by petitioner. The pertinent provisions of Section 27 of the Revenue Code read 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 -

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;

x x x

(h) Club organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net income of which inures to the benefit of any private stockholder or member; x x x."

Paragraph (e) of Section 27 exempts from income tax organizations or clubs organized and operated exclusively for athletic purposes, along with religious, charitable, scientific, cultural, and educational organizations, no part of the net income of which inures to the benefit of any private stockholder or individual. Paragraph (h) also exempts from income tax clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net income of which inures to the benefit of any private stockholder or member, more commonly denominated as social clubs.

Under the Federal Income Tax Law of the United States, there is no provision specifically exempting athletic clubs from income tax. However, clubs organized for the promotion of athletics and sports of all kinds solely to provide recreation and entertainment of their members are classified as social clubs and are exempt from income tax.

> "If social or athletic features of Club are a material part of its activities and promote its existence and advancement, it is a 'social club' within Revenue Act. Lake of the Forest Club v. U. S., CCA Kan., 137 F. 2d 843, 845." (39 Words & Phrases, 546.)

Our law, however, has provided for the exemption of athletic clubs as a distinct class apart from social clubs. Is petitioner in this case an athletic club or a social club?

It appears that petitioner is a non-stock corporation organized on August 18, 1909 for the purpose of "the maintenance of a club to promote social intercourse among men, and to provide a place for them to meet and have social gatherings, recreation and entertainment." (Par. Second, Articles of Incorporation, Exh. A.) Section 2 of its By-Laws provides:

> "Sec. 2. The object of this Club shall be to promote the game of Polo, other athletic sports and out-door recreations and to give opportunity for social intercourse to residents of the Philippine Islands and visitors thereto. The buildings and land shall be used for the purposes of a country club and there shall always be maintained a polo field and a club house. Club buildings, houses and cottages may be provided for residents and places of entertainments for members, but not as a place of business, other than the regular and proper business of a Club."

To enable it to carry out its objectives, it acquired a parcel of land in Pasay under a trust agreement providing that "said land should be used for the purpose of encouraging, promoting and developing the game of polo and/or any and all other outdoor, amateur athletic sports, games, exercises and pursuits, and the conducting, playing and enjoyment thereof, and for any purposes or uses incidental or convenient thereto, including a polo and country club, and/or other athletic club or clubs."

While the name adopted by petitioner is "Manila Polo Club", its activities are not limited to the game of polo. Of the 750 members of the club, only 15 are polo playing members. It has provided facilities for other games and sports for the entertainment and recreation of its members, such as, bowling, badminton, swimming, tennis, baseball, volleyball, softball and parlor games. It has also a dancing pavilion for its members.

From the evidence of record, it appears to us that the facilities provided by the club to enable its members to participate in athletic games and sports are designed solely to provide recreation and entertainment to all its members and not to develop athletes. It is essentially a club organized and operated exclusively "for pleasure, recreation, and other non-profitable purposes" within the meaning of paragraph (h) of Section 27, and hence a social club.

But whether petitioner is an athletic club or a social club is of little or no significance in the resolution of the question whether it is exempt from or liable to the income tax on the gain realized from the sale of its Pasay property. Let us first consider the case from the viewpoint of respondent that petitioner is an athletic club and that its exemption is governed by paragraph (e) of Section 27.

As already stated, petitioner was compelled to sell a substantial portion of its Pasay property to the U. S. Government because it was needed by the U.S. Army. The remainder became inadequate for its club activities so that it was deemed necessary to sell or dispose of it at a reasonable price. A portion was in fact sold to the Manila Yellow Taxicab Co. and another portion, consisting of about 2 hectares, was donated to the Government for use as park and playground. Respondent considers the gain realized by petitioner from the sales as taxable income by virtue of the proviso contained in paragraph (e) of Section 27 "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."

In the case of the Union Church of Manila, a corporation or association organized and operated exclusively for religious purposes, a similar question was presented. The facts of the case are as follows:

> "(1) The Union Church of Manila is a corporation or association organized and operated exclusively for religious purposes; it is the owner of a lot situated at the corner of Padre Faura and Mabini Streets, Ermità, Manila, and of the church building and improvements thereon.
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> "(2) The immediate vicinity of the church, it is stated, has ceased to be a residential district and is fast developing into an area for commercial establishments and amusement places. Due allegedly to this fact and in order to serve better its members most of whom now reside in the suburbs of Manila, the transfer of the church to a suitable place in the neighborhood of Forbes Park and San Lorenzo Village has become necessary.
>
> "(3) With this end in view, the Union Church intends to sell the said church site together with the buildings thereon and, with the proceeds thereof, acquire a new site in the locality mentioned above and construct a new church building thereon. It is estimated that the proceeds would not be sufficient to cover the total cost thereof so that the same would have to be augmented by voluntary contributions from the members of the church.
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> "(4) Before proceeding with the sale of said property, the Union Church submitted the matter to the Bureau of Internal Revenue for a ruling on whether or not the amount which the selling price shall exceed the original cost of said property would be subject to the income tax. By letter dated June 3, 1958, the Commissioner of Internal Revenue replied that

> his Office was 'of the opinion that the excess of the selling price over the original cost of the abovementioned property is subject to income tax, even if such income is to be used by the Union Church of Manila in the purchase of a new church site and the construction thereon of a new church building.' This conclusion, it appears, is predicated on section 30 of the Income Tax Regulations which states that 'profits from the sale of property, real or personal,' are considered generally as part of the taxable income of exempt organizations." (See Opinion No. 45, S. of 1959, of the Secretary of Justice.)

The case was finally submitted to the Secretary of Justice, who rendered an opinion to the effect that the gain to be realized by the Union Church from the sale of its Ermita property would be <u>exempt</u> from income tax. We are quoting pertinent portions of said opinion (Op. No. 45, S. of 1956) with which we are in entire agreement:

> "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 <u>has not resulted in taking the income</u> of the plaintiff, consisting of 'rents on land, dividends ... interests on loans ... etc.' ... <u>out of the operation of the exemption</u> 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 in-

come 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. Thus, I am more inclined to subscribe to the view that the projected sale at a profit of the present site and church building of the Union Church of Manila, for the sole purpose of acquiring a new site and constructing a new church in a place where most of its members now reside, does not come within the reach of the proviso of section 27 (e) quoted above, and is therefore not subject to the income tax. I attach great weight to the fact that the Union Church, which is organized and operated exclusively for religious purposes, owns and holds said property for religious purposes, and is going to part with the same solely for religious purposes, i.e., the transfer of the church to a new site. The profit or income resulting from the transaction would be merely incidental to said religious purposes. And as the present church site was not acquired for speculation or as an investment to be eventually sold primarily for monetary gain, I think there is reason enough to say that income to be derived from the sale of said property is not within the contemplation of the proviso of said section 27(e).

"This view, it will be observed, is in harmony with the ruling of your Office regarding the sale of the properties, at a profit, of the Union Club of the Philippines, Inc., incident to the dissolution of the Club. In reply to an inquiry as to the tax liability of the club, the Commissioner of Internal Revenue ruled that since the Union Club was a social club, organized and operated exclusively for pleasure, recreation and other non-profitable purposes, within the purview of section 27(h) of the tax code, 'the sale of its property at a profit in furtherance of its purpose, or to facilitate its dissolution, and the subsequent division of the net assets among the members, are exempt from income tax.' The case of Santee Club v. White (87 F. 2d 5) may also be cited in support of my opinion. In that case, it was held that the plaintiff, a club organized to acquire lands and maintain the same 'as a hunting and fishing preserve, and as a pleasure and health resort for its members,' no part of the net earnings of which inured to the benefit of anyone of them, was exempt from taxation of the profit realized on the sale of a portion of its land which had become valueless for its purposes and used for improvements of other parts of the Club's property; and that since this single profitable transaction was incidental to the general activities of the club and was not made in pursuance of any plan to change its general purposes, it did not constitute 'engaging in business' so as to render such profit taxable as income.

"If the profit realized from the sale of the properties of a social club in the process of dissolution and distributed to its members was tax exempt, and if the net gain derived from the sale of part of a club's hunting preserve which had become valueless for its purposes and used for the improvement of the remaining property of the club was likewise tax exempt, there appears to be no substantial reason for holding that the net proceeds of the sale of a church building and its site, which would be used to defray the cost of a new church in a new location, should be subject to the income tax."

Respondent himself has apparently been convinced of the correctness of said opinion of the Secretary of Justice as evidenced by his letter dated March 20, 1959 to the counsel for the Union Church, which reads:

"With reference to your letter dated July 7, 1958, written for and in behalf of the Union Church of Manila, I have the honor to inform you that the excess of the selling price over the original cost of the church building and lot of said religious corporation is exempt from the income tax provided that the net proceeds from the sale of the church building and its site would be used by it exclusively in the purchase of a new church site and the construction thereon of a new church building in accordance with the ruling of the Secretary of Justice dated March 10, 1959."

We cannot perceive any material difference between the instant case and that of the Union Church of Manila, the two organizations being exempt from income tax under the same paragraph (e) of Section 27, considering petitioner as an athletic club as held by respondent.

Would the result be different if petitioner is a social club, as insisted by it? Where a social club sells any of its properties, the taxability of the gain derived from the sale depends, as a rule, upon whether the sale was made as an incident of its regular activities or whether it was made solely for profit in disregard of its purposes.

> "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 purpose 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.)

It has been held, therefore, that where a social club sold a portion of its land which had become valueless for its purposes and the proceeds used for improvements of other parts of the club's property, the profit realized from the sale was exempt from tax. (Santee Club v. White, supra.) In another case, a golf club was forced to buy a golf course tract, and,

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unable to sell the unused portion as a single unit, sold it off gradually in small parcels. The profit derived from the sales of the unused portion of the land was held exempt from income tax. (Anderson Country Club, 2 TC 1238.) The exemption is not lost even if the proceeds of the sale were invested and earned interest pending acquisition of new property, although such interest constituted substantial part of the club's income. (IT 3302, CB 1939-2, p. 105, cited in Par. 4398, PH Fed. Taxes, 1955.)

In this case, petitioner was forced to sell a substantial portion of its Pasay property because it was needed by the U.S. Army. As the remaining portion was not enough for its purposes, it had to dispose of the same, and it was generous enough to donate a portion to the Government for use as park and playground. The entire proceeds of the sale were used to acquire another property in Makati and for necessary improvements, all of which are essential for the accomplishment of the club's purposes. The disposition of the Pasay property and the acquisition of the new property in Makati are undoubtedly not only incidental but are necessary to accomplish the purposes for which the petitioner was organized. We are, therefore, of the opinion that the profit derived by petitioner as a social club from the sale of its Pasay property is not subject to income tax.

Having arrived at the conclusion that the income realized by petitioner from the sale of its Pasay property, whether it is considered as an athletic club or as a social club, is exempt from income tax, we find it unnecessary to pass upon the other issues raised by the parties.

WHEREFORE, the decision appealed from is reversed, without pronouncement as to costs.

SO ORDERED.

Manila, August 31, 1959.

ROMAN M. UMALI
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

~~AUGUSTO M. LUCIANO~~
Associate Judge