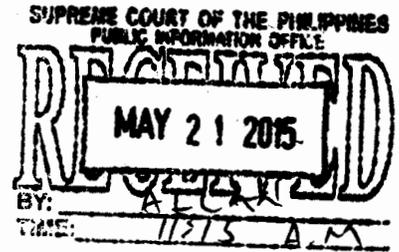




Republic of the Philippines
Supreme Court
Baguio City

THIRD DIVISION

NOTICE



Sirs/Mesdames:

Please take notice that the Court, Third Division, issued a Resolution dated April 15, 2015, which reads as follows:

“G.R. No. 200688 (Commissioner of Internal Revenue vs. St. Luke’s Medical Center, Inc.). – The Commissioner of Internal Revenue (CIR) filed the instant petition¹ under Rule 45 of the Rules of Court, assailing the Decision² dated October 5, 2011 of the Court of Tax Appeals (CTA) *en banc*, as well as its Resolution³ dated February 20, 2012 in the consolidated cases of CTA EB Case No. 634 and CTA EB Case No. 636.

The facts are undisputed.⁴

In 2003, assessment notices were issued by the CIR to St. Luke’s Medical Center, Inc. (SLMCI) for deficiency income taxes for the taxable years 2000, 2001, and 2002, totaling ₱218,098,488.02, which included surcharges, interests and penalties. The assessments were based on the CIR’s argument that SLMCI is not being operated purely for charitable and social welfare purposes as only 13% of its operations for 1998 were allocated to charitable purposes, and that its board of trustees, officers and employees directly benefited from its profits and assets.⁵

SLMCI was able to file an administrative protest on October 29, 2003. The CIR, however, did not act on the protest within the period prescribed by law.⁶ After the period lapsed on April 28, 2004, SLMCI filed a petition for review with the CTA.

¹ Rollo, pp. 14-44.

² Id. at 51-76.

³ Id. at 79-86.

⁴ The parties entered into a Joint Stipulation of Facts and Issues; see CTA *en banc* Decision dated October 5, 2011, id. at 53-57.

⁵ Id. at 53-54.

⁶ National Internal Revenue Code, Section 228, id.

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Ruling of the CTA Second Division

On November 21, 2008, the CTA Second Division promulgated its Decision⁷ ordering SLMCI to pay the following: a) ₱711,996.45 for deficiency income tax for taxable year 2000; b) ₱24,717,932.15 for deficiency income tax for taxable year 2001; and c) ₱17,933,548.63 for deficiency income tax for taxable year 2002; including surcharges as provided by Section 248 of the National Internal Revenue Code (NIRC), as amended, and delinquency interests, pursuant to Section 249 of the NIRC. SLMCI's total tax liability was thus computed by the CTA Second Division at ₱43,363,477.23.⁸

The CTA Second Division found that SLMCI is a non-stock, non-profit corporation organized for charitable and social welfare purposes whose income is primarily derived from its hospital operations; hence, income from its hospital operations is exempt from income tax under Section 30 of the 1997 NIRC. Nevertheless, the CTA Second Division also found that SLMCI generates 'other income', which must be subjected to the imposition of corporate income tax under Section 30, in relation to Section 32 of the 1997 NIRC. The CTA Second Division, however, found that since SLMCI failed to disclose the breakdown of its other income for taxable years 2000, 2001 and 2002 – making it unable to determine the nature of SLMCI's various incomes, the CTA ordered the payment of deficiency corporate income taxes for 2000, 2001 and 2002 on its non-operating activities based on the Income Tax Returns filed by SLMCI for said years, at the rate of 32%.⁹

Both parties filed their respective motions for partial reconsideration and on March 19, 2009, the CTA Second Division issued a Resolution allowing SLMCI to present additional evidence to support its claim that its 'other income' for 2001 and 2002 was composed mainly of interest income and foreign exchange gain the final taxes of which had already been withheld.

On May 11, 2010, the CTA Second Division promulgated an Amended Decision,¹⁰ the dispositive portion of which reads:

WHEREFORE, premises considered:

1. respondent Commissioner of Internal Revenue's "Motion for Partial Reconsideration" is hereby **DENIED** for lack of merit; and

⁷ Penned by Associate Justice Olga Palanca-Enriquez, with Associate Justices Juanito C. Castañeda, Jr. and Erlinda P. Uy concurring; id. at 87-115.

⁸ Id. at 113-114.

⁹ Id. at 109-114.

¹⁰ Id. at 116-132.

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2. petitioner St. Luke's "Motion for Partial Reconsideration" is hereby **PARTLY GRANTED**. Accordingly, the dispositive portion of our Decision dated November 21, 2008 is hereby amended to read, as follows:

WHEREFORE, premises considered, the present Petition [for] Review is **PARTIALLY GRANTED**. Petitioner St. Luke's Medical Center, Inc. is hereby **ORDERED** to pay only the amounts of **SEVEN HUNDRED ELEVEN THOUSAND NINE HUNDRED NINETY[-]SIX AND [45/100] PESOS (P711,996.45)** for deficiency income tax for taxable year 2000; **THREE MILLION THREE HUNDRED SIXTY THOUSAND ONE HUNDRED THIRTY[-]THREE AND 36/100 PESOS (P3,360,133.36)** for deficiency income tax for taxable year 2001; and **TWO MILLION FIFTY[-]THREE THOUSAND TWO HUNDRED THIRTY[-]THREE AND 59/100 PESOS (P2,053,233.59)** for deficiency income tax for taxable year 2002; or the total amount of **SIX MILLION ONE HUNDRED TWENTY[-]FIVE THOUSAND THREE HUNDRED SIXTY[-]THREE AND 40/100 PESOS (P6,125,363.40)**.

In addition, petitioner is hereby **ORDERED** to pay respondent 20% delinquency interest per annum on the total amount of **P6,125,363.40** counted from October 30, 2003 until full payment thereof, pursuant to *Section 249 (C) of the NIRC of 1997, as amended*.

SO ORDERED.¹¹

Not satisfied with the amended decision of the CTA Second Division, both the CIR and the SLMCI filed their respective petitions for review before the CTA *en banc*.¹²

Ruling of the CTA *en banc*

Quoting largely the CTA Second Division's disquisition, the CTA *en banc* affirmed the amended decision. The dispositive portion of the assailed CTA *en banc* Decision¹³ dated October 5, 2011 reads:

WHEREFORE, the [petitions] for [review] are hereby **DENIED** for lack of merit. Accordingly, the impugned Amended Decision of the Court in Division dated May 11, 2010, in the CTA Case No. 6993, is hereby **AFFIRMED *in toto***. St. Luke's Medical Center, Inc., is hereby **ORDERED TO PAY** the following amounts of P711,996.45, for deficiency income tax for the taxable year 2000; P3,360,133.36 for deficiency income tax for the taxable year 2001; and P2,053,233.59 for deficiency income tax for the taxable year 2002; or in the aggregate amount of P6,125,363.40.

In addition, St. Luke's Medical Center, Inc., is hereby **ORDERED TO PAY** twenty percent (20%) delinquency interest per annum on the total amount of P6,125,363.40, counted from October 30, 2003, until full

¹¹ Id. at 130-131.

¹² Id. at 24.

¹³ Id. at 51-76.

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payment thereof, pursuant to Section 249(C) of the 1997 NIRC, as amended.

SO ORDERED.¹⁴

Undaunted, the CIR filed a Motion for Reconsideration¹⁵ but it was denied by the CTA *en banc* in the assailed Resolution¹⁶ dated February 20, 2012.

Hence this petition.

The CIR raises the lone issue of whether the CTA *en banc* committed a reversible error in affirming the ruling of the CTA Second Division that under Section 30(E) and (G) of the 1997 NIRC, SLMCI is exempt from payment of deficiency income taxes for the years 2000 to 2002 on income derived from its hospital operations.¹⁷

In support of its position, the CIR argues that: a) SLMCI should be made subject to 10% income tax pursuant to Section 27(B) of the 1997 NIRC, which is a specific provision that prevails over Section 30, which is a general one; b) the inclusion in Section 27(B) of proprietary hospitals that are non-profit as among those subject to 10% income tax clearly reveals the intention of the legislature to remove the income tax exemption of said entities which they used to enjoy under Section 26(e) and (g) of the 1977 NIRC; and c) assuming, for the sake of argument, that Section 30 of the 1997 NIRC is applicable, SLMCI is not exempt from paying income tax under subsection (E) because it cannot be considered as a corporation operated exclusively for charitable purpose as there is no finding that its funds are devoted exclusively to the maintenance of its hospital. The CIR also contends that neither can SLMCI be considered exempt under Section 30(G) since it applies only to civic leagues or organizations and not to corporations like the SLMCI.¹⁸

On September 3, 2012, the SLMCI filed its Comment/Opposition¹⁹ and counters that: a) it cannot be considered as an entity covered by the provisions of Section 27(B) of the 1997 NIRC for being a non-stock, non-profit hospital operated exclusively for charitable and social welfare purposes; b) it is covered by Section 30(E) and (G) of the 1997 NIRC which exempts non-stock, non-profit charitable and social welfare hospitals from income tax; and c) as to the CIR's contention that Section 27(B) prevails over Section 30(E), SLMCI quoted the CTA *en banc*'s interpretation "that non-stock, non-profit hospitals operated exclusively for charitable purpose are exempt from income tax on income received by them as such, applying

¹⁴ Id. at 74.
¹⁵ Id. at 150-157.
¹⁶ Id. at 79-86.
¹⁷ Id. at 31.
¹⁸ Id. at 31-40.
¹⁹ Id. at 171-182.

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the provisions of Section 30(E) of the 1997 NIRC, as amended," based on rules of statutory construction.

In the interim, the Court promulgated on September 26, 2012 a Decision in the consolidated cases docketed as **G.R. Nos. 195909 and 195960** and entitled, *Commissioner of Internal Revenue v. St. Luke's Medical Center, Inc.* and *St. Luke's Medical Center, Inc. v. Commissioner of Internal Revenue*.²⁰ The Court in these cases resolved the same issue of whether SLMCI is liable for deficiency income tax under Section 27(B) of the NIRC, which imposes a preferential tax rate of 10% on the income of proprietary non-profit hospitals, albeit for the year 1998. Partially granting the CIR's petition, the Court modified CTA *en banc* Decision dated November 19, 2010 and Resolution dated March 1, 2011 in CTA Case No. 6746, and ordered SLMCI to pay the deficiency income tax in 1998 based on the 10% preferential income tax rate under Section 27(B) of the NIRC, among others.

The dispositive portion of the Court's Decision in *St. Luke's Medical Center, Inc.* provides:

WHEREFORE, the petition of the Commissioner of Internal Revenue in G.R. No. 195909 is PARTLY GRANTED. The Decision of the Court of Tax Appeals *En Banc* dated 19 November 2010 and its Resolution dated 1 March 2011 in CTA Case No. 6746 are MODIFIED. St. Luke's Medical Center, Inc. is ORDERED TO PAY the deficiency income tax in 1998 based on the 10% preferential income tax rate under Section 27(B) of the National Internal Revenue Code. However, it is not liable for surcharges and interest on such deficiency income tax under Sections 248 and 249 of the National Internal Revenue Code. All other parts of the Decision and Resolution of the Court of Tax Appeals are AFFIRMED.

The petition of St. Luke's Medical Center, Inc. in G.R. No. 195960 is DENIED for violating Section I, Rule 45 of the Rules of Court.

SO ORDERED.²¹

On April 25, 2013, the CIR filed its Reply²² and invoked the Court's ruling in *St. Luke's Medical Center, Inc.*

Thereafter, SLMCI filed on May 30, 2013 a Manifestation and Motion,²³ stating that in accordance with *St. Luke's Medical Center, Inc.*, it already paid the amount of basic taxes due for the taxable years 1998, 2000 to 2002, and 2004 to 2007, which payment was duly accepted and received by the Bureau of Internal Revenue (BIR). Accordingly, the pending issues concerning taxable years 2000, 2001 and 2002, which are the subject matter

²⁰ Hereinafter referred to as *St. Luke's Medical Center, Inc.*, 682 SCRA 66.

²¹ Id. at 93.

²² *Rollo*, pp. 209-220.

²³ Id. at 224-226.

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of this petition, are now deemed moot and academic, and SLMCI prays for the dismissal of the present petition with prejudice.²⁴

The CIR in its Comment²⁵ dated January 3, 2014, confirmed that SLMCI has already paid the amounts of ₱36,938,203.70, ₱51,906,377.90, and ₱55,691,769.50 representing the basic taxes for the years 2000, 2001 and 2002. It was further disclosed that SLMCI applied for abatement of penalties for the taxes due for the said taxable years. Consequently, the CIR interposed no objection to the dismissal of the present petition, provided that the same would be without prejudice to whatever appropriate action that may be taken anent SLMCI's application for the abatement of penalties for taxable years 2000, 2001 and 2002.²⁶

Ruling of the Court

St. Luke's Medical Center, Inc. ruled that SLMCI is not a corporation that is "operated exclusively" for charitable or social welfare purposes insofar as its revenues from paying patients are concerned. The Court discussed the rationale, as follows:

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).

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 conducted not for profit.

"Non-profit" does not necessarily mean "charitable." x x x.

x x x x

²⁴ Id.
²⁵ Id. at 238-240.
²⁶ Id. at 238.

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To be a charitable institution, however, an organization must meet the substantive test of charity in *Lung Center*. The issue in *Lung Center* concerns exemption from real property tax and not income tax. However, it provides for the test of charity in our jurisdiction. Charity is essentially a gift to an indefinite number of persons which lessens the burden of government. **In other words, charitable institutions provide for free goods and services to the public which would otherwise fall on the shoulders of government.** Thus, as a matter of efficiency, the government forgoes taxes which should have been spent to address public needs, because certain private entities already assume a part of the burden. This is the rationale for the tax exemption of charitable institutions. The loss of taxes by the government is compensated by its relief from doing public works which would have been funded by appropriations from the Treasury.

Charitable institutions, however, are not *ipso facto* entitled to a tax exemption. x x x.

x x x x

The Constitution exempts charitable institutions only from real property taxes. In the NIRC, Congress decided to extend the exemption to income taxes. However, the way Congress crafted Section 30(E) of the NIRC is materially different from Section 28(3), Article VI of the Constitution. Section 30(E) of the NIRC defines the corporation or association that is exempt from income tax. On the other hand, Section 28(3), Article VI of the Constitution does not define a charitable institution, but requires that the institution "actually, directly and exclusively" use the property for a charitable purpose.

x x x x

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."

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.

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.**

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.

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%.

In 1998, St. Luke's had total revenues of P1,730,367,965[.00] 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." Indeed, St. Luke's admits that it derived profits from its paying patients. St. Luke's declared P1,730,367,965[.00] as "Revenues from Services to Patients" in contrast to its "Free Services" expenditure of P218,187,498[.00]. x x x.

x x x x

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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[.00] for non-paying patients.

St. Luke’s claims that its charity expenditure of P218,187,498[.00] 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.”**

x x x x

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).

x x x x

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

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preferential tax rate of 10% on its net income from its for-profit activities.²⁷ (Citations omitted and emphasis and italics in the original)

Thus, the Court concluded in *St. Luke's Medical Center, Inc.* that SLMCI is liable for deficiency income tax in 1998 under Section 27(B) of the 1997 NIRC.

*Stare decisis et non quieta movere.*²⁸ Where the same questions relating to the same event have been put forward by the parties similarly situated as in a previous case litigated and decided by a competent court, the rule of *stare decisis* is a bar to any attempt to relitigate the same issue. Given that the present petition involves the same parties and the same issue resolved in *St. Luke's Medical Center, Inc.*, the Court so holds that under Section 27(B) of the 1997 NIRC, SLMCI is liable for deficiency income taxes for the years 2000, 2001 and 2002 at the preferential tax rate of 10% on its net income from its for-profit activities. Given further that SLMCI already paid the deficiency income taxes due for the years 2000, 2001 and 2002, which payment has been admitted by the CIR, there is, therefore, no more reason to discuss at length its actual tax liability.

Likewise, the imposition of taxes and surcharges should be deleted in accordance with the ruling in *St. Luke's Medical Center, Inc.* that –

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."²⁹ (Citations omitted and italics in the original)

Note that in this case, the CIR admitted that the BIR issued a letter of exemption dated June 9, 1990,³⁰ and having relied thereon, SLMCI should not be held liable for surcharges and interests on its deficiency taxes for the years 2000, 2001 and 2002.

WHEREFORE, the petition is **DISMISSED.**" (Jardeleza, J., no part in view of participation in the Office of the Solicitor General; Leonen, J., designated additional Member per Raffle dated April 6, 2015; Villarama, Jr., J., on sabbatical leave; Mendoza, J., designated additional Member per Special Order No. 1966 dated March 30, 2015.)

²⁷ Supra note 20, at 81-92.

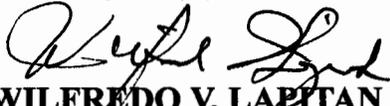
²⁸ "Stand by the decisions and disturb not what is settled."

²⁹ Supra note 20, at 92-93.

³⁰ *Rollo*, p. 137.

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Very truly yours,


WILFREDO V. LAPITAN
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5/14/15

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