695 Phil. 867

SECOND DIVISION

[G.R. No. 195909, September 26, 2012]

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. ST. LUKE'S MEDICAL CENTER, INC., RESPONDENT.

[G.R. NO. 195960]

ST. LUKE'S MEDICAL CENTER, INC., PETITIONER, VS. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

D E C I S I O N

CARPIO, J.:

The Case

These are consolidated[1] petitions for review on certiorari under Rule 45 of the Rules of Court assailing the Decision of 19 November 2010 of the Court of Tax Appeals (CTA) *En Banc* and its Resolution[2] of 1 March 2011 in CTA Case No. 6746. This Court resolves this case on a pure question of law, which involves the interpretation of Section 27(B) *vis-à-vis* Section 30(E) and (G) of the National Internal Revenue Code of the Philippines (NIRC), on the income tax treatment of proprietary non-profit hospitals.

The Facts

St. Luke's Medical Center, Inc. (St. Luke's) is a hospital organized as a non-stock and non-profit corporation. Under its articles of incorporation, among its corporate purposes are:

> (a) To establish, equip, operate and maintain a non-stock, non-profit Christian, benevolent, charitable and scientific hospital which shall give curative, rehabilitative and spiritual care to the sick, diseased and disabled persons; provided that purely medical and surgical services shall be performed by duly licensed physicians and surgeons who may be freely and individually contracted by patients;
>
> (b) To provide a career of health science education and provide medical services to the community through organized clinics in such specialties as the facilities and resources of the corporation make possible;
>
> (c) To carry on educational activities related to the maintenance and promotion of health as well as provide facilities for scientific and medical researches which, in the opinion of the Board of Trustees, may be justified by the facilities, personnel, funds, or other requirements that are

available;

(d) To cooperate with organized medical societies, agencies of both government and private sector; establish rules and regulations consistent with the highest professional ethics;

x x x x[3]

On 16 December 2002, the Bureau of Internal Revenue (BIR) assessed St. Luke's deficiency taxes amounting to P76,063,116.06 for 1998, comprised of deficiency income tax, value-added tax, withholding tax on compensation and expanded withholding tax. The BIR reduced the amount to P63,935,351.57 during trial in the First Division of the CTA.[4]

On 14 January 2003, St. Luke's filed an administrative protest with the BIR against the deficiency tax assessments. The BIR did not act on the protest within the 180-day period under Section 228 of the NIRC. Thus, St. Luke's appealed to the CTA.

The BIR argued before the CTA that Section 27(B) of the NIRC, which imposes a 10% preferential tax rate on the income of proprietary non-profit hospitals, should be applicable to St. Luke's. According to the BIR, Section 27(B), introduced in 1997, "is a new provision intended to amend the exemption on non-profit hospitals that were previously categorized as non-stock, non-profit corporations under Section 26 of the 1997 Tax Code x x x."[5] It is a specific provision which prevails over the general exemption on income tax granted under Section 30(E) and (G) for non-stock, non-profit charitable institutions and civic organizations promoting social welfare.[6]

The BIR claimed that St. Luke's was actually operating for profit in 1998 because only 13% of its revenues came from charitable purposes. Moreover, the hospital's board of trustees, officers and employees directly benefit from its profits and assets. St. Luke's had total revenues of P1,730,367,965 or approximately P1.73 billion from patient services in 1998.[7]

St. Luke's contended that the BIR should not consider its total revenues, because its free services to patients was P218,187,498 or 65.20% of its 1998 operating income (*i.e.*, total revenues less operating expenses) of P334,642,615.[8] St. Luke's also claimed that its income does not inure to the benefit of any individual.

St. Luke's maintained that it is a non-stock and non-profit institution for charitable and social welfare purposes under Section 30(E) and (G) of the NIRC. It argued that the making of profit *per se* does not destroy its income tax exemption.

The petition of the BIR before this Court in G.R. No. 195909 reiterates its arguments before the CTA that Section 27(B) applies to St. Luke's. The petition raises the sole issue of whether the enactment of Section 27(B) takes proprietary non-profit hospitals out of the income tax exemption under Section 30 of the NIRC and instead, imposes a preferential rate of 10% on their taxable income. The BIR prays that St. Luke's be ordered to pay P57,659,981.19 as deficiency income and expanded withholding tax for 1998 with surcharges and interest for late payment.

The petition of St. Luke's in G.R. No. 195960 raises factual matters on the treatment and withholding of a part of its income,[9] as well as the payment of surcharge and delinquency interest. There is no ground for this Court to undertake such a factual review. Under the Constitution[10] and the Rules of Court,[11] this Court's review power is generally limited to "cases in which only an error or question of law is involved."[12] This Court cannot depart from this limitation if a party fails to invoke a recognized exception.

<u>The Ruling of the Court of Tax Appeals</u>

The CTA *En Banc* Decision on 19 November 2010 affirmed *in toto* the CTA First Division Decision dated 23 February 2009 which held:

> **WHEREFORE**, the Amended Petition for Review [by St. Luke's] is hereby **PARTIALLY GRANTED**. Accordingly, the 1998 deficiency VAT assessment issued by respondent against petitioner in the amount of P110,000.00 is hereby **CANCELLED** and WITHDRAWN. However, petitioner is hereby **ORDERED** to PAY deficiency income tax and deficiency expanded withholding tax for the taxable year 1998 in the respective amounts of P5,496,963.54 and P778,406.84 or in the sum of P6,275,370.38, x x x.
>
> x x x x
>
> In addition, petitioner is hereby **ORDERED** to **PAY** twenty percent (20%) delinquency interest on the total amount of P6,275,370.38 counted from October 15, 2003 until full payment thereof, pursuant to Section 249(C)(3) of the NIRC of 1997.
>
> **SO ORDERED**.[13]

The deficiency income tax of P5,496,963.54, ordered by the CTA *En Banc* to be paid, arose from the failure of St. Luke's to prove that part of its income in 1998 (declared as "Other Income-Net")[14] came from charitable activities. The CTA cancelled the remainder of the P63,113,952.79 deficiency assessed by the BIR based on the 10% tax rate under Section 27(B) of the NIRC, which the CTA *En Banc* held was not applicable to St. Luke's.[15]

The CTA ruled that St. Luke's is a non-stock and non-profit charitable institution covered by Section 30(E) and (G) of the NIRC. This ruling would exempt all income derived by St. Luke's from services to its patients, whether paying or non-paying. The CTA reiterated its earlier decision in *St. Luke's Medical Center, Inc. v. Commissioner of Internal Revenue*,[16] which examined the primary purposes of St. Luke's under its articles of incorporation and various documents[17] identifying St. Luke's as a charitable institution.

The CTA adopted the test in *Hospital de San Juan de Dios, Inc. v. Pasay City*,[18] which states that "a charitable institution does not lose its charitable character and its consequent exemption from taxation merely because recipients of its benefits who are able to pay are required to do so, where funds derived in this manner are devoted to the charitable purposes of the institution x x x."[19] The generation of income from paying patients does not per se destroy the charitable nature of St. Luke's.

Hospital de San Juan cited *Jesus Sacred Heart College v. Collector of Internal Revenue,*[20] which ruled that the old NIRC (Commonwealth Act No. 466, as amended)[21] "positively exempts from taxation those corporations or associations which, otherwise, would be subject thereto, because of the existence of x x x net income."[22] The NIRC of 1997 substantially reproduces the provision on charitable institutions of the old NIRC. Thus, in rejecting the argument that tax exemption is lost whenever there is net income, the Court in Jesus Sacred Heart College declared: "[E]very responsible organization must be run to at least insure its existence, by operating within the limits of its own resources, especially its regular income. In other words, it should always strive, whenever possible, to have a surplus."[23]

The CTA held that Section 27(B) of the present NIRC does not apply to St. Luke's.[24] The CTA explained that to apply the 10% preferential rate, Section 27(B) requires a hospital to be "non-profit." On the other hand, Congress specifically used the word "non-stock" to qualify a charitable "corporation or association" in Section 30(E) of the NIRC. According to the CTA, this is unique in the present tax code, indicating an intent to exempt this type of charitable organization from income tax. Section 27(B) does not require that the hospital be "non-stock." The CTA stated, "it is clear that non-stock, non-profit hospitals operated exclusively for charitable purpose are exempt from income tax on income received by them as such, applying the provision of *Section 30(E) of the NIRC of 1997, as amended*."[25]

The Issue

The sole issue is whether St. Luke's is liable for deficiency income tax in 1998 under Section 27(B) of the NIRC, which imposes a preferential tax rate of 10% on the income of proprietary non-profit hospitals.

The Ruling of the Court

St. Luke's Petition in G.R. No. 195960

As a preliminary matter, this Court denies the petition of St. Luke's in G.R. No. 195960 because the petition raises factual issues. Under Section 1, Rule 45 of the Rules of Court, "[t]he petition shall raise only questions of law which must be distinctly set forth." St. Luke's cites *Martinez v. Court of Appeals*[26] which permits factual review "when the Court of Appeals [in this case, the CTA] manifestly overlooked certain relevant facts not disputed by the parties and which, if properly considered, would justify a different conclusion."[27]

This Court does not see how the CTA overlooked relevant facts. St. Luke's itself stated that the CTA "disregarded the testimony of [its] witness, Romeo B. Mary, being allegedly self-serving, to show the nature of the 'Other Income-Net' x x x."[28]

This is not a case of overlooking or failing to consider relevant evidence. The CTA obviously considered the evidence and concluded that it is self-serving. The CTA declared that it has "gone through the records of this case and found no other evidence aside from the self-serving affidavit executed by [the] witnesses [of St. Luke's] x x x."[29]

The deficiency tax on "Other Income-Net" stands. Thus, St. Luke's is liable to pay the 25% surcharge under Section 248(A)(3) of the NIRC. There is "[f]ailure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment[.]"[30] St. Luke's is also liable to pay 20% delinquency interest under Section 249(C)(3) of the NIRC.[31] As explained by the CTA En Banc, the amount of P6,275,370.38 in the dispositive portion of the CTA First Division Decision includes only deficiency interest under Section 249(A) and (B) of the NIRC and not delinquency interest.[32]

__The Main Issue__

The issue raised by the BIR is a purely legal one. It involves the effect of the introduction of Section 27(B) in the NIRC of 1997 *vis-à-vis* Section 30(E) and (G) on the income tax exemption of charitable and social welfare institutions. The 10% income tax rate under Section 27(B) specifically pertains to proprietary educational institutions and proprietary non-profit hospitals. The BIR argues that Congress intended to remove the exemption that non-profit hospitals previously enjoyed under Section 27(E) of the NIRC of 1977, which is now substantially reproduced in Section 30(E) of the NIRC of 1997.[33] Section 27(B) of the present NIRC provides:

> SEC. 27. Rates of Income Tax on Domestic Corporations. —
>
> x x x x
>
> (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. (Emphasis supplied)