

REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Date: 31 October 2012

REVENUE MEMORANDUM CIRCULAR NO. 67-2012

TO : All Internal Revenue Officials and Employees Concerned

RE : Circularization of the pertinent portions of the Supreme Court Decision in G.R. Nos. 195909 and 195960 dated 26 September 2012, entitled “*Commissioner of Internal Revenue -vs- St. Luke’s Medical Center, Inc.*,” on the income tax treatment of proprietary non-profit hospitals under Section 27(B) vis-à-vis Sections 30[E] and [G] of the National Internal Revenue Code (NIRC), as amended, and on the 1998 deficiency income tax liability of St. Lukes Medical Center, Inc., on the revenues it derived from services to paying patients pursuant to Section 27[B] of the NIRC, as amended, and their tax implications and the implementation thereof.

For the information and guidance of all internal revenue officials and employees concerned, quoted hereunder are the relevant portions of the Supreme Court Decision in G.R. Nos. 195909 and 195960 dated 26 September 2012, entitled “*Commissioner of Internal Revenue -vs- St. Luke’s Medical Center, Inc.*” involving the following:

1. On the meaning of “*proprietary*” and “*non-profit*” as applied to (i) proprietary non-profit educational institutions and (ii) proprietary non-profit hospitals under Section 27(B) of the NIRC, as amended:

“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." (underlining supplied)

Henceforth, private non-profit hospitals and educational institutions whose gross income from unrelated trade, business or other activity does not exceed fifty percent (50%) of their total gross income derived from all sources, shall pay a tax of ten percent (10%) on their taxable income except those covered by Section 27(D) of the NIRC. However, the following shall be subject to the tax prescribed under Section 27(A) of the NIRC or the regular corporate tax rate on their taxable income, except those covered by Section 27(D) of the NIRC:

- a. Private non-profit hospitals and educational institutions whose gross income from unrelated trade, business or other activity exceeds fifty percent (50%) of their total gross income derived from all sources, or
- b. Hospitals and educational institutions claiming to be within the coverage of Section 27[B] of the NIRC that fails to meet the above definition of "*proprietary*" and "*non-profit*".

In all cases, whether their income tax rates fall under Section 27[A] or 27[B] of the NIRC, the aforesaid institutions are likewise subject to other applicable taxes, if warranted.

2. On the definition of "*charitable*" institutions for purposes of enjoying income tax exemption under Section 30[E] of the NIRC, as amended:

"The Court defined "charity" in *Lung Center of the Philippines v. Quezon City* as "a gift, to be applied consistently with existing laws, **for the benefit of an indefinite number of persons**, either by bringing their minds and hearts under the influence of education or religion, by assisting them to establish themselves in life or [by] **otherwise lessening the burden of government.**" A non-profit club for the benefit of its members fails this test. An organization may be considered as non-profit if it does not distribute any part of its income to stockholders or members. However, despite its being a tax exempt institution, any income such institution earns from activities conducted for profit is taxable, as expressly provided in the last paragraph of Section 30.

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. (underlining supplied)

Henceforth, non-stock, non-profit corporations or associations which claim to be charitable institutions, yet, they fail to meet the aforestated definition of “*charitable*” institutions, are not entitled to income tax-exemption under Section 30[E] of the NIRC, as amended, and their taxable income shall be subject to ordinary 30% corporate rate under Section 27(A) of the NIRC. They are likewise subject to other applicable taxes, if warranted.

3. On the requirements to qualify as “*charitable*” or “*social welfare*” non-stock, non-profit corporations and associations under Sections 30[E] and [G] of the NIRC, as amended:

“Section 30(E) of the NIRC provides that a charitable institution must be:

- (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.

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. 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." (underlining supplied)

Henceforth, non-stock, non-profit corporations or associations which claim to be charitable or social welfare but do not organized and operated "exclusively" for charitable or social welfare purposes as above-defined are not entitled to the income tax-exemption under Sections 30[E] and [G] of the NIRC, as amended, and their taxable income shall be subject to ordinary 30% corporate rate under Section 27(A) of the NIRC, as amended. They are likewise subject to other applicable taxes, if warranted.

4. On the taxability pursuant to Section 27[B] of the NIRC, as amended, of revenues derived by proprietary non-profit hospitals from services to paying patients and by proprietary non-profit educational institutions from the same or similar services:

"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."

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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.**"

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. . . . 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.

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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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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.

All concerned revenue officials and employees are hereby directed to fully implement the decision of the Supreme Court in G.R. Nos. 195909 and 195960 dated 26 September 2012, entitled "*Commissioner of Internal Revenue -vs- St. Luke's Medical Center, Inc.*," by ensuring that the proper taxes are collected from private non-profit hospitals and educational institutions starting from January 1, 1998.

Accordingly, all concerned revenue officials and employees engaged in the audit and review of audit cases are enjoined to assess deficiency income taxes and other applicable taxes, if warranted, on the kinds of transactions set forth above.

All revenue officials and employees are enjoined to give to give this Circular as wide publicity as possible.

(Original Signed)
KIM S. JACINTO-HENARES
Commissioner of Internal Revenue