May 10, 2018

BIR RULING NO. 804-18

Section 30 (E) of the NIRC of 1997, as amended

St. Martin's Mission Hospital, Inc.
San Roque, Poblacion, Sablayan,
Occidental Mindoro 5104

Attention: *AAA*

Gentlemen :

This refers to your undated letter received by this Office on June 3, 2013, requesting on behalf of **ST. MARTIN'S MISSION HOSPITAL, INC.** for the issuance of a certificate of tax exemption being enjoyed by non-stock, non-profit corporation or association organized and operated exclusively for charitable purposes under Section 30 (E) of the National Internal Revenue Code of 1997, as amended.

It is represented that **ST. MARTIN'S MISSION HOSPITAL, INC.** with Tax Identification No. (TIN) 000-000-000-0000, is a non-stock, non-profit corporation duly organized under the laws of the Philippines; that is registered with the Securities and Exchange Commission (SEC) under Registration No. A200016394; and that the purposes for which it was incorporated as appearing in its Articles of Incorporation are the following:

1. *To establish, equip, operate and maintain on a non-stock, non-profit basis a Christian benevolent, charitable, education and scientific hospital which shall provide medical and surgical and nursing or other care for the sick, infirm, injured persons, regardless of creed, nationality or economic and social status subject to the condition that purely professional, medical or surgical services in connection therewith shall be performed by duly qualified physicians or surgeons who may or may not be connected with the corporation and who shall be freely and individually contracted by patients; provided that no profit shall inure to the benefit of any officer, director or member of the corporation;*

2. *To establish and operate school of Nursing and/or other fields of education related to hospital services;*

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3. *To provide instruction and consolation of the Christian religion to those who are under the care of the institution; and*

4. *To establish rules and regulations consistent with the highest professional ethics, governing the admission and discharge of patients, staff and personnel discipline, fiscal operations, and hospital management, as well as the employment of modern scientific methods and procedures in the treatment of disease.*

In reply, please be informed as follows:

Income Tax

Section 30 (E) of the National Internal Revenue Code of 1997, as amended, provides, *viz.*:

"Sec. 30. Exempt 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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(E) Non-stock 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;

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In the case of *Commissioner of Internal Revenue vs. St. Luke's Medical Center, Inc.* [1] the Supreme Court states that:

"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. *The requirements for a tax exemption are specified by the law granting it. The power of Congress to tax implies the power to exempt from tax. Congress can create tax exemptions, subject to the constitutional provision that "[n]o law granting any tax exemption shall be passed without the concurrence of a majority of*

all the Members of Congress." The requirements for a tax exemption are strictly construed against the taxpayer because an exemption restricts the collection of taxes necessary for the existence of the government.

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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.*

However, the last paragraph of Section 30 of the NIRC qualifies the words

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"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.*** *(Emphasis supplied)*

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 . . . charitable . . . purposes. . . ." 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%.*

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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.***

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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).*

A tax exemption is effectively a social subsidy granted by the State because an exempt institution is spared from sharing in the expenses of government and yet benefits from them. Tax exemptions for charitable institutions should therefore be

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limited to institutions beneficial to the public and those which improve social welfare. A profit-making entity should not be allowed to exploit this subsidy to the detriment of the government and other taxpayers.

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."

In view of the foregoing, there is no dispute that **ST. MARTIN'S MISSION HOSPITAL, INC.** is organized as a non-stock and non-profit corporation. However, this does not automatically exempt **ST. MARTIN'S MISSION HOSPITAL, INC.** from paying taxes. Even if **ST. MARTIN'S MISSION HOSPITAL, INC.** meets the test of charity, it is not *ipso facto* tax exempt. To be exempt from income taxes, Section 30 (E) of the National Internal Revenue Code of 1997, as amended, requires that a charitable institution must be "organized and operated exclusively" for charitable purposes.

In the same case of *Commissioner of Internal Revenue vs. St. Luke's Medical Center, Inc.,* [2] citing the case of *Lung Center of the Philippines v. Quezon City*, [3] the Supreme Court states that:

"[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." . . . 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."***

Examination of the audited financial statements of **ST. MARTIN'S MISSION HOSPITAL, INC.** shows that it is not operated exclusively for charitable purposes as it mainly derives income from the services to paying patients and operation as a hospital which are all for-profit activities. Thus, **ST. MARTIN'S MISSION HOSPITAL, INC.** fails to meet the requirements under Section 30 (E) of the National Internal Revenue Code of 1997, as amended, to be income tax exempt. As such, revenues of **ST. MARTIN'S MISSION HOSPITAL, INC.** is subject to ten percent (10%) preferential tax rate as imposed by Section 27 (B) of the National Internal Revenue Code of 1997, as amended.

Value-Added Tax

Section 109 (G) of the National Internal Revenue Code of 1997, as amended, provides that:

"***SEC. 109. Exempt Transactions.*** —

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(1) Subject to the provisions of Subsection (2) hereof, the following transactions shall be exempt from the value-added tax.

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(G) Medical, dental, hospital and veterinary services except those rendered by professionals.

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Accordingly, the hospital services of **ST. MARTIN'S MISSION HOSPITAL, INC.** shall be exempt from twelve percent (12%) value-added tax (VAT). This VAT exemption includes the operation of a pharmacy or drugstore and sale of drugs to hospital's **in-patients**. This is in accordance with the ruling of the Court of Tax Appeals in the case of *Hermano (San) Miguel Febres Cordero Medical Education Foundation (De La Salle-Health Sciences Institute), Inc. vs. Commissioner of Internal Revenue*, [4] which states that:

"The Court stands by its pronouncement that sale of drugs or pharmaceutical items to in-patients of the hospital is considered part of the term "hospital services" covered by the exemption from VAT under Section 109 (G) of the NIRC of 1997, as amended, 'because the maintenance and operation of a pharmacy or drugstore by a hospital is a necessary and essential service or facility rendered by any hospital for its patients.' To recapitulate, reproduced hereunder are the pertinent cases that guided this Court in rendering the above pronouncement:

Perpetual Succour Hospital, Inc., et al. vs. Commissioner of Internal Revenue: [5]

"Pursuant to the above Supreme Court decision, taxpayers engaged in hospital services are exempt from VAT. Republic Act No. 4226 defines hospital as a place devoted primarily to the maintenance and operation of facilities for the diagnosis, treatment and care of individuals suffering from illness, disease, injury or deformity, or in need of obstetrical or other medical and nursing care (Section 2 (a) thereof). In other words, a hospital is a place where persons are given medical or surgical treatment. Hence, hospital services include not only the services of the doctors, nurses and allied medical personnel, but also the necessary laboratory services, and making available the medicines, drugs and pharmaceutical items that are necessary in the diagnosis, treatment and care of patients. Sale of drugs or pharmaceutical items to in-patients of the hospital are (sic), therefore, considered part of the hospital services covered by Section 109 (l) of the NIRC of 1997, as amended."

Commissioner of Internal Revenue vs. Professional Services, Inc.: [6]

"The said ruling cited the decision of the Court of Appeals in St. Luke's Medical Center v. Court of Tax Appeals and Commissioner of Internal Revenue. In that case, the Court of Appeals ruled that the item "hospital services" in Section 103 (1) should include the sale of drugs to in-patients of the hospital because the maintenance and operation of a pharmacy or drugstore by a hospital is a necessary

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and essential service or facility rendered by any hospital for its patients. The Court of Appeals further explained that, "a person who resorts to the hospital for medical treatment can reasonably expect that the hospital would make available to its patients immediate and prompt access not only to the services of doctors, nurses and allied medical personnel, but also to necessary laboratory services as well as medicines, drugs and pharmaceutical items which are dispensable aids in practically any form of medical treatment and care of patients." It went on to say that, "the sale of drugs or pharmaceutical items to in-patients of the hospital should be exempted from VAT because unlike the sale of retailing of drugs or medicines by drugstores in general, the procurement of medicines and pharmaceutical items from the hospital drugstore or pharmacy amounts to the availment of service rendered or made available by the hospital for its in-patients and not simply the buying of such goods."

However, if the sale of medicine is made to **out-patients**, such sale is subject to VAT, pursuant to Section 105 of the National Internal Revenue Code of 1997, as amended. Thus, the pharmacy sales of **ST. MARTIN'S MISSION HOSPITAL, INC.** to **out-patients** are subject to VAT.

Notwithstanding that hospital services rendered by **ST. MARTIN'S MISSION HOSPITAL, INC.** are exempt from VAT, its purchase of goods or properties or services and importation of goods shall nevertheless be subject to the 12% VAT pursuant to Section 107 of the National Internal Revenue Code of 1997, as amended.

It should be noted that VAT is an indirect tax payable by the seller and not by the purchaser of goods. However, being an indirect tax, it can be shifted or passed on to the buyer/purchaser, transferee or lessee of the goods, properties or services. Once shifted to the buyer/customer as an addition to the post of the goods or services sold, it is no longer a tax but an additional cost which the buyer/customer has to pay in order to obtain the goods or services.

As long as **ST. MARTIN'S MISSION HOSPITAL, INC.** will not engage in the regular conduct of a commercial or economic activity not in connection with its primary purposes, it will remain exempt from 12% VAT.

Under Section 235 of the National Internal Revenue Code of 1997, as amended, any provision of existing general and special law to the contrary notwithstanding, the books of accounts and other pertinent records of tax-exempt organization or grantees of tax incentives shall be subject to examination by the BIR for purposes of ascertaining compliance with the conditions under which it has been granted tax exemptions or tax incentives, and its tax liabilities, if any.

Finally, it is subject to the payment of the annual registration fee of Php500.00 as prescribed in Section 236 (B) of the National Internal Revenue Code of 1997, as amended. It is also required under Section 6 (C) in relation to Section 237 of the same Code to issue duly registered receipts or sales or commercial invoices for each or transfer

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of merchandise or for services rendered which are not directly related to the activities for which the association is registered. [Revenue Memorandum Circular (RMC) No. 76-2003].

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be disclosed that the facts are different, then this ruling shall be considered null and void.

Very truly yours,

(SGD.) CAESAR R. DULAY
Commissioner of Internal Revenue

Footnotes

1. G.R. No. 195909, September 26, 2012.
2. G.R. No. 195909, September 26, 2012.
3. G.R. No. 144104, 29 June 2004, 433 SCRA 119.
4. C.T.A. Case No. 8194, May 15, 2012.
5. CTA Case No. 7304, December 1, 2010.
6. CTA EB No. 409, January 8, 2009.

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