

## TAX-EXEMPT EDUCATIONAL CORPORATION IN THE PHILIPPINES

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In the Philippines, due to the tremendous growth of our population yearly, and classroom capacity not being able to cope with it, we have been having not only an educational but also a spiritual lag in the training of our youth. Educating the youth is a high priority public service and since the government alone cannot solve the problem of a persistent lack of schools, sectarian and non-sectarian schools and colleges have been established. Some are corporations set up by private stockholders organized for educational purposes but paying dividends to their stockholders when profits are realized. Some are non-profit stock or non-stock corporations also organized for educational purposes, the profits if any, not being distributed to any stockholder or individual.

Educational profit-distributing corporations are governed by Section 24 of the National Internal Revenue Code, paying 10% on their net taxable income. The second category of educational corporations are exempted from taxation under Section 27-e of the same Code. It is with the exempted corporations that we will deal with.<sup>1</sup>

### **The 'Why' Behind The Exemptions:**

Section 27-e of the Code states that the following organizations shall not be taxed in respect to income received by them as such:

<sup>1</sup> *National Internal Revenue Code, Comm. Act No. 666 as amended to Aug., 1964* (Manila, Bureau of Printing, 1964).

'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 an income, shall be liable to the tax imposed under this Code.'

Why are these corporations exempt from taxation? Exemption from taxation means freedom from the payment of taxes imposed by the government to pay for its own public administration expenses, as well as those which are demanded by the public needs of its citizens. Said tax exemptions have been allowed for various reasons, sometimes to encourage industries needed by the economy or to subsidize indirectly those corporations which pursue a purpose for the common good or welfare of the people.<sup>2</sup>

The fundamental principle of taxation is that taxes are levied on the people to raise money that will be disbursed by the government for a public undertaking and/or for other public purposes. Some of these purposes are national defense, social and economic development and the education of the people. Religious educational institutions fall under the 'public policy' exemption motive of the government. Exemptions have been granted to religious, educational, charitable and other similar institutions on the theory that they benefit the public, encourage the fulfillment of a public purpose or perform socially desirable functions. They supplement the educational purposes of the government and perform functions, public in nature, which would originally have been carried out by the government at taxpayers' expense. Thus, these corporations do the work of the government and it is for this reason that exemption is granted under Section 27-e. Their incomes are not levied taxes because they need the income, not for profit that will redound to the benefit of any stockholder or individual but to carry out their educational and other declared aims.

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<sup>2</sup> S. Guevara, *Essentials of Phil. Business Law*. (Manila, Atlas Publishing Co., 1963).

**When Exemptions Are Granted:**

Exemptions are granted to such corporations if: (1) they are organized for one or more specified purposes: (2) no part of their net income inures to the benefit of any stockholder or individual.

A parochial school or private educational corporation organized for educational or religious purposes as embodied in its articles of incorporation is exempted from income taxes under Section 27-e. The mere absence in the articles of incorporation of a clause that the corporation is a non-profit organization, does not, per se, convert it into a profit-making corporation. The determining factors are its purpose, which is required by law to be clearly stated in the articles of incorporation as well as the conduct of its ordinary activities, whether or not it is engaged in business for profit to be distributed among its stockholders. In a case decided by the Court of Tax Appeals, 'Collector of Internal Revenue vs. University of Visayas, G. R. No. L-3554, February 28, 1961', after confirming that exemptions should fulfill the above two provisos regarding purpose and disposition of income, the court also declared that it did not matter whether the educational corporation was stock or non-stock.

What would be the effect of collateral activities of the school, for example, selling uniforms, textbooks, operating a canteen and other activities inside the school premises in which some profit was made? Can tax exemptions still be claimed for such profits? The courts have been lenient in the interpretation of the law, always taking into consideration the fact that said corporations are not primarily engaged in profit but only secondarily as a means to realize their religious or educational purposes. The 'destination of income' if used exclusively for the purpose of organization in many instances prevailed as the real test of exemption. In the case, 'Immaculate Conception Academy of Manila vs. Commissioner of Internal Revenue, CTA case no. 582, June 28, 1961,' the Academy was declared by the Court of Tax Appeals to be exempt from income taxation even from such profit for the following reasons:

- (a) The purpose of the school was a religious and educational one;

- (b) Sales were made only inside the school premises and only to the students of the school;
- (c) Said activities were made to further attain the educational objective of the school, and if any profit was realized, it was applied to the operating expenses made in connection with said sales;
- (d) No profit was distributed to any stockholder or individual.

In other cases decided by the courts, it was declared that the criterion for exemption is the consideration that the institution gives to the public in the form of public service. To say that an institution is subject to tax if it makes a profit is tantamount to nullifying its exemptions because then, the institution will be taxed whenever there is a profit. Said organizations have to operate within their resources and to do so they have to make regular incomes in order to maintain themselves from day to day and also to be able to contemplate future expansion.

#### **How Exemptions Are Granted:**

How can a corporation claim exemption under Section 27-e? In order to do so, a corporation has to file with the Commissioner of Internal Revenue an affidavit showing the following:

- (a) The nature and character of the organization;
- (b) Its actual functions;
- (c) Its purpose,
- (d) Sources and disposition of its income;
- (e) That no part of the net income inures or may inure to any stockholder or individual;
- (f) If part of the net income is credited to surplus, a copy of the articles of incorporation, its by-laws, and the latest financial statement showing its assets, liabilities, receipts and disbursements of the association should be submitted together with the affidavit.

The Commissioner of Internal Revenue, upon sufficient evidence of the data submitted, can declare the corporation as exempt. From then on, the right of exemption is established and the corporation is not required to show further its status under the law, except in case the original character and operations for which it was organized are substantially altered.<sup>3</sup>

#### **When Income Of Tax-exempt Corporations Is Taxable:**

Section 27-e continues under 'Provided, however' . . . . that 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 the Code. This refers to income derived from rentals collected from real estate owned by the corporation aside from the plant—land and buildings used by the corporation for its educational purpose, which is free from taxes as provided by the Constitution. Dividends and interest from stocks, bonds and bank deposits are also taxable. From these various forms of income are deducted the expenses incurred such as repairs, depreciation, losses on sale of bonds and stock. On the net taxable income, the educational corporation pays a tax.

The theory behind the imposition of taxes on said income is that the government affords protection to the owners of said rental and other properties and therefore it is but proper that the owners be made to contribute to the cost of government by paying taxes on the income derived.

#### **Current Sensitive Areas Of Tax Exemptions:**

In the Philippines, the religious non-profit tax-exempt educational or charitable corporation is so profound in our society that there is apparently no need for anyone to state that the obvious purpose of permitting such an institution to flourish, is to encourage individual citizens and groups to take the initiative in caring for the sick, educating the young or fostering the arts.

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<sup>3</sup> Jose Aranas, *Annotations, and Jurisprudence on the National Internal Revenue Code, as amended* (Manila, S. H. Gwekoh Printing, 1958).

Still, there have been signs of sensitivity by our leaders as the 'provided, however' clause tucked to Section 27-e by Section 5, Republic Act no. 82, removing tax exemptions from the other income. In the 'U. S. News and World Report' magazine of July 10, 1967, there are allegations that churches, more and more are going into business, buying up farms, factories and real estate for tax free profits that support religious and educational work. There are arguments for proposed federal legislation which would preclude churches from exploiting their tax-exempt status. The National Council of Catholic Men has even endorsed the principle of requiring religious corporations to pay taxes on 'unrelated income' in order to remove the undemocratic advantage which they now enjoy in competing with corporations and small businessmen.<sup>4</sup> This proposal would have a similar effect as the amendment to Section 27-e.

Recently in his regular column published in the 'Weekly Nation' of Feb. 26, 1968, Vicente Albano Pacis wrote an article 'For Tax Purposes, Schools Should Be Equal'. According to him, Senator Alejandro Almendras has proposed in the Senate that sectarian schools and colleges should be taxed on their profits just as the secular private schools are now being taxed, both corporate and income taxes. Mr. Pacis' views on the matter ran on a similar vein. To him, the present tax policy on schools is erratic and discriminatory. The government should tax all of them or exempt all of them from taxes equally, and that the latter is the wiser and more enlightened policy, since both of them, whether profit or non-profit, were supplementing the public education system. The condoned taxes now collected from non-sectarian schools should be earmarked for scholarships in this country, which in American universities constitute as much as 40% of the students, a condition that enables the USA to raise large numbers of highly educated young people.

Certainly, the above agitations would provoke pros and cons from various parties in the Philippines. The pros for taxing sectarian non-

<sup>4</sup> *Tax Exemption, The Constitution and Catholics-Some Reflections*, by R. T. Drinan, S. J., in the 'The Homelitic and Pastoral Review', Sept., 1967. Vol. LXVII, no. 12.

profit educational institutions would present valid arguments and the cons would be as vocal about their reasons. Most of the sectarian educational institutions are run by religious communities, who by virtue of their modest and retiring personalities have not publicized their innumerable scholarships and charities granted to deserving individuals as well as their other various 'good works'. Many laymen, being ignorant of the extent of their work, have been under the impression that vast wealth is being accumulated by them. It seems, therefore, that better public relations together with a disclosure of the revenues, expenses and disposition of the balances remaining would be desirable among the tax-exempt corporations in order to counteract such propositions.

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### IMPORTANCE OF CATHOLIC SCHOOLS

*"Among all the agencies of education the school has a special importance. By virtue of its very purpose while it cultivates the intellect with unremitting attention, the school ripens the capacity for right judgement, provides an introduction into the cultural heritage won by past generations, promotes a sense of values, and readies for professional life."*