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SPECIAL REPORT

Government Taxation of Private Education

THOMAS R. FITZPATRICK

The year 1975 witnessed the imposition of both a property tax and an income tax on all private non-stock, non-profit educational institutions. The property tax began with the calendar year 1975; the income tax of 10% began for schools with the fiscal year, which for most schools begins April 1 or May 1. This, then, is an appropriate time to review the issues involved in taxation of private schools.

The issues involved have been set forth in several position papers prepared by this writer. These position papers are now presented in *Philippine Studies*, together with related government documents and decrees, with the intention of clarifying the issues and giving the main steps which have led to the present state of the question.

The first position paper, prepared in February 1973, at the request of Dean Marcos Herras, President of the Catholic Educational Association of the Philippines, outlined the rationale for government assistance to private educational institutions by incentives in the form of exemption from certain taxes.

[*Document 1: Position Paper on Tax Incentives*]

The second position paper, likewise prepared at the request of the President of the Catholic Educational Association of the Philippines, was submitted to the Secretary of Finance on 27 March 1973, and developed positive reasons why private educational institutions should be exempt from property tax.

[*Document 2: Position Paper on Property Tax*]

On 4 April 1973, the Secretary of Education in a memorandum to the President of the Philippines, took the stand that all private educational institutions should be exempt from property tax, but should be subjected to a ten percent tax on the overall net income.

[Document 3: Memorandum of the Secretary of Education]

In October 1973, Presidential Decrees 304 and 305 were issued. While P.D. 261 had imposed a property tax on land and buildings of private educational institutions, using a fifteen percent assessment level, to become effective calendar year 1974, P.D. 304 postponed this tax until calendar year 1975. P.D. 305 imposed a ten percent tax on overall net income for the next fiscal year that began after 1 July 1974.

In November 1973, I prepared an assessment of these two decrees for a conference of school administrators.

[Document 4: Presidential Decree 304]

[Document 5: Presidential Decree 305]

[Document 6: Assessment of the Decrees]

In April 1974, the position of the government was explained in an open letter of the Secretary of Finance, Cesar Virata. This letter received wide circulation and was reproduced in the form of large posters by the National Media Production Center.

[Document 7: Letter of Secretary Virata]

At that time, a reply was drafted, but to my knowledge, never sent. That reply appears here for the first time.

[Document 8: Draft of a Letter Replying to Secretary Virata]

In April 1975, P.D. 675 was issued granting a gradually decreasing discount on property tax over a four-year period.

The following telegram was received at the Catholic Educational Association of the Philippines from Secretary Guillermo de Vega, Malacañang:

THE PRESIDENT INSTRUCTED ME TO ADVISE YOU THAT HE HAS SIGNED A DECREE GRANTING DISCOUNTS ON REAL PROPERTY TAX ON PROPERTIES DIRECTLY AND EXCLUSIVELY USED FOR EDUCATIONAL PURPOSES STARTING WITH CALENDAR YEAR 1975 STOP UNDER THE DECREE A REAL PROPERTY TAX DISCOUNT OF SIXTY PERCENT SHALL BE GRANTED IN 1975 SEMICOLON FORTY PERCENT IN 1976 AND TWENTY PERCENT IN 1977 STOP DECREE IS RESULT OF STUDIES MADE BY SECRETARY OF FINANCE IN VIEW OF REPRESENTATION OF YOUR GOODSSELVES AND FROM PRIVATE SCHOOLS AFFECTED BY TAX STOP REGARDS.

The latest development in the area of taxation of private schools is the work of the Department of Education and Culture in the drafting of The Private Education Code. The work on this Code began in September 1974. The Code itself has been through several revisions; the section in the Code on incentives has likewise gone through several revisions. In the latest draft, the incentives proposed would remove property tax and income tax, and give several other incentives not presently available.

[*Document 9: Draft of Private Education Code on incentives*]

In the event that The Private Education Code is implemented by Presidential Decree subsequent to the publication of this article, and should the section on incentives have been substantially modified, a comparative study of the provisions in the draft and the provisions of the decree will be in order.

19 August 1975

DOCUMENT 1

Position Paper Concerning Government Assistance to Private Education by Incentives in the Form of Exemption from Certain Taxes.

Prepared by Father Thomas R. Fitzpatrick, S.J., at the request of Dean Marcos Herras, President of the Catholic Educational Association of the Philippines, 22 February 1973.

At the present time, the government uses incentives to encourage firms organized on a profit basis to do business in certain areas which the government considers as vital for the economic well-being of the country.

It goes without saying that a key ingredient, if not the most important ingredient in economic development, is the development of human resources.

Thus, in the overall strategy for economic development, the development of human resources through a responsive educational system should receive high priority in government planning.

That it does receive high priority in other countries is demonstrated by the fact that many countries give a positive subsidy to students in private education. (Confer Benabarre, where he develops the idea that a government should be willing to give a subsidy to every student in the private educational system, with the level of subsidy being determined by the actual cost to the government of a student on the same level in the public sector.)¹

At the present time, the school system of the Philippines is composed of the public schools and the private schools. The private schools are organized either on a non-profit or on a proprietary basis. Since most religious schools are organized as non-profit, and the proprietary schools generally do not have affiliation with any one religious group, the division between non-profit and proprietary is sometimes mistakenly referred to as a division between sectarian and non-sectarian schools. It is submitted that this is a false issue. The determining factor for distinguishing between the two types of private schools is whether there is an option for declaring dividends, to benefit the individual stockholder. Where there is this option, a tax at a preferential rate is imposed on the net income.

The educational system as a whole, and each of its parts, the public sector and the private sector, have their strengths and their weaknesses, and different sub-systems are at various stages of development within the overall system. Admittedly, there are wastages in both the public and the private sector. (Confer Beeby, *The Quality of Education in Developing Countries*. [Harvard, 1966]).

The parents of the students who enroll in the private sector are in effect subject to double taxation; that is, they pay their taxes, for which they are entitled to free public schooling; yet in freely choosing to send their children to a private school, they pay an additional amount to the private school.

The government, at the present time, cannot possibly afford to pay for the development of the human resources at all levels. Nor can the government reasonably hope that by its own efforts alone, through the public sector, it can provide for the requirements of a growing population. Even with the assistance of existing private schools, the number of student positions will have to be increased to meet the population requirements.

Except for assistance given through FAPE (Fund for Assistance to Private Education) which is a very recent development and quite minimal

1. Benigno Benabarre, *Public Funds for Private Schools in a Democracy: Theory and Practice in Fifty-One Countries* (Manila: MCS Enterprises, 1958), pp. 51 ff.

considering the requirements of the private schools, the government has not been in a position to give aid to private education. This appears unreasonable, since education leans, and will continue to lean, heavily on the private sector.

To date, the basic assistance from the government has been in the form of a *negative* subsidy, that is, through the exemption from property tax of land and buildings used exclusively for educational purposes; and through the partial exemption from income tax (preferential rate of 10% on net profit of proprietary schools; for non-profit schools, no tax on school income; tax only on income from real and personal property).

The recently approved Constitution removes educational institutions from the property tax exemption. From a reading of deliberations of the Committee on Taxation and Debt Management, I would hazard the guess that "educational" was removed not in order to deprive educational institutions of this negative assistance, but because the delegates felt this exemption did not belong in the Constitution, but would best be enacted later by Congress (early stages of discussion) or by the National Assembly (later stages). In this way, the proper safeguards could be established.

The net effect of this removal is that just at the time when private schools were beginning to hope for some form of government assistance in the form of direct subsidy or by way of a tax credit to the individual student, all of a sudden they are faced with the burden of a new expense that they had never envisioned, that of a property tax expense. This burden will hurt every school, proprietary and non-profit. It will hurt some more than others. Schools which invested in decent physical facilities, and developed ample grounds and athletic fields for the proper educational setting and environment will be harder hit than schools which got by with the minimum of facilities and which used the street or other public area for playgrounds. But while some will be hurt less than others, all will be hurt.

Since student fees constitute the primary source of financing for the private schools, the only way that the added burden can be provided for is by increasing income from the students, i.e., by increasing tuition, or by charging a property tax fee. Sad to say, parents of private school children will then be subject, not to double taxation, but to *triple* taxation.

Many schools, desiring to cooperate with the objectives of the New Society, had attempted to keep tuition increases for 1973-74 to a minimum. Should the property tax remain, the schools are left with very little choice as to their course of action.

If the government plans to continue its reliance on the private sector to meet the challenge of the growing population and the growth in quality of the human resource;

if the government recognizes that the private schools are performing a *public service*, that is, a service which the government would have to provide should it not be provided by these institutions;

if the government wants to encourage the improvement of facilities by maximizing the plow-back of profits into the school operation,

THEN THE GOVERNMENT SHOULD CONTINUE AND, IF POSSIBLE, IN-

CREASE ITS ASSISTANCE, INITIALLY IN THE FORM OF A NEGATIVE SUBSIDY THROUGH TAX EXEMPTIONS.

1. The exemption from property tax should be restored, retroactive to the date when the new Constitution was approved, not by way of amending the Constitution, but by provision of law. Proper safeguards should be set up so that exemption applies to property and improvements *actually* used and used *exclusively* for educational purposes.

2. To encourage the improvement of facilities, and to give incentives to the plow-back of profit into the school operation, the exemption from income tax should be broadened to afford equal treatment to the income of proprietary and non-profit schools which is plowed back into the operation. The norm for exemption should be revised and reverted back to the norm used prior to 1935, that of destination of income, rather than source of income.

The exemption should extend to sources of income from real and personal property, as has been previously recommended by the joint legislative tax commission in 1966.

This exemption is felt to be a matter of *justice*.

... It is recognized that the exemption of educational and charitable institutions from income tax should be liberally construed since it is not a matter of *grace* but an act of *public justice*; such an exemption is made in recognition of the benefits which the public derives from the corporate activities of such institutions. (Opinion 1762, Series 1940, Department of Justice).

It is inconceivable that the New Society in its concern for justice towards all would enact a measure which would be violative of this form of *public justice*.

With special reference to the proprietary schools, any profit not plowed back into the school operation and which is paid by way of a reasonable cash dividend will be subject to a tax of 10%. This rate should be preferential, to encourage investors to maintain their investment and invest additional funds in the new schools that will be needed. If a local or national government can float a school bond issue to encourage citizens to invest in the development of human resources, with the incentive of a fair rate of return, is there any reason in the Philippine setting to discourage those who invest in schools, or to bring about a dis-investment in private proprietary schools?

Granted that the funds so plowed back will increase the total owner's equity and consequently the market value of the shares, when it comes time to sell these shares, the stockholder will be subject to tax *at that time*, as in any other sale of stock.

Loopholes will be plugged and proper safeguards will be set up to be observed by both the non-profit and the proprietary institutions in the private sector.

3. To encourage the continuation of donations from abroad to schools and foundations (relief organizations are already provided for in section 105, letter e), and to encourage schools and foundations to invest in

scientific apparatus to ensure their participation in the advance of science and technology, an exemption from duties on such importations should be given. The exemption constitutes merely one new general classification to the twenty others (a to t) that are already set up in section 105 of the revised Tariff and Customs Code. Section 105 has its own safeguards which should be incorporated and which are acceptable to the schools. Additional limitations might also be imposed, e.g., a prohibition on the importation of donated luxury items, which would find no use in the school setting. It is my opinion that by and large private educational institutions have in the past used this privilege in a responsible manner, and there is no reason for assuming they will act otherwise in the future.

These are the basic incentives that should be given to every private educational institution duly recognized by the Department of Education and Culture, in view of their basic contribution to public service.

Where schools fail to perform this basic public service at the level of performance expected by the Department of Education and Culture, appropriate remedial measures should be taken.

Where some particular contribution is identified which can best be met by some sector of private education, over and beyond their basic contribution, the government should establish added assistance and incentives, as outlined in Presidential Decree No. 6-A.

Given the proper assistance, the private educational system can continue to make a valuable contribution in developing and improving the quality of the human resource. Without this human resource, any plan to develop material resources is bound to fail.

DOCUMENT 2

Position Paper Concerning a Proposal to Assess a Property Tax on the Land and Buildings of All Private Educational Institutions.

Prepared by Father Thomas R. Fitzpatrick, S.J., at the request of Dean Marcos Herras, President of the Catholic Educational Association of the Philippines. Submitted by Dean Herras to the Committee on Real Property Assessment, Department of Finance, 26 March 1973.

HISTORICAL PERSPECTIVE

1935 Constitution²

The exemption from property tax for educational institutions was established in the 1935 Constitution. The amendment, as first presented by Delegate Cloribel, did not contain the word "educational":

2. Joaquin Bernas, *A Historical and Juridical Study of the Philippine Bill of Rights* (Manila: Ateneo de Manila University Press, 1971), pp. 154-155.

Churches, convents and their accessories, cemeteries, buildings, and other improvements owned by any sect or religious institutions used exclusively for religious purpose shall be exempted from taxation.

This was a copy of section 2-A, subsection (4) of the Philippine Independence Law. The original draft of the Constitution had already placed this provision in an ordinance to be appended to the Constitution because this was one of the mandatory provisions prescribed by the Independence Law. Cloribel, however, wanted it to be part of the permanent body of the Constitution. He said that "if churches, convents [rectories or parsonages] and their accessories are always necessary for facilitating the exercise of such [religious] freedom, it would also be natural that their existence be also guaranteed by exempting them from taxation." The amendment was readily approved and it now reads:

Cemeteries, churches, and parsonages or convents appurtenant thereto, and all lands, buildings, and improvements used exclusively for religious, charitable, or educational purposes shall be exempt from taxation.

1973 Constitution

The word "educational" has been omitted from the 1973 Constitution.

Sec. 17 . . .

(3) Charitable institutions, churches, parsonages or convents appurtenant thereto, mosques, and non-profit cemeteries, and all lands, buildings and improvements actually, directly, and exclusively used for religious or charitable purposes shall be exempt from taxation.

Why was "educational" omitted from the 1973 Constitution? Was it the intention of the delegates in removing "educational" institutions, to make educational institutions subject to tax?

Since this topic was not discussed in any detail in the plenary sessions of the Convention, the only sources available are the deliberations of the Committee on Taxation and Debt Management. This Committee met fourteen times and the question of property tax exemption came up for discussion in three meetings: October 22, 1971; January 5, 1972; and March 6, 1972.

While there was a strong minority opinion expressed in the first meeting for doing away with the whole section from the Constitution, it was in order to let Congress (National Assembly) decide on the matter of tax exemption. Exemption was to be per provision of the law and not per provision of the Constitution.

In the second meeting, held on January 5, 1972,³ it was emphasized that

3. It should be noted that at the time of this meeting many schools had just announced their proposals for increasing tuition fees for the

the proposed retention of religious and charitable institutions was to protect religious liberty, while the elimination of "educational" would not affect religious liberty. As of February 10, 1972, "educational" had been eliminated by the Committee from the first draft to the Steering Committee. The First Draft, Legislative Department, Article 4, Section 16 read:

Non-profit cemeteries, churches and parsonages or convents appurtenant thereto, and all lands, buildings and improvements actually and directly used exclusively for religious and charitable purposes, including devisees, legacies and donations to public schools and hospitals shall be exempt from taxation.

In the last meeting, however, in which this topic was discussed, the meeting held on March 6, 1972, a motion to reinsert "educational" as an exempting purpose on the condition that it be non-profit, was presented, signed by a clear and overwhelming majority of the members (twenty-four, to be exact). In discussing this motion, an argument was put forth by one delegate to exempt *all* private educational institutions, including proprietary ones:

The more buildings they construct, the better for our educational institutions, the better for our country. If we subject the real properties, the buildings that they construct, to real property tax, they will be discouraged from constructing the same. My view, Mr. Chairman, is that in the matter of education, it is the primary obligation of the State. We should be thankful that some institutions are going into this and taking over the work . . . which should be the work of the government. Now, I would even go further and suggest to the Committee on Education to subsidize these schools so that the tuition fees they collect will be lesser . . . The only question here is, are we going to subject them to real property tax or not? I believe, Mr. Chairman, we should retain the present provision of the Constitution exempting private educational institutions only from real property tax. More than that (that they be subject to income tax), let us leave that to the Congress as presently provided for in the Tax Code . . .

After further discussion on the distinction between profit and non-profit schools, and a suggestion that since this issue is a very important substantial issue, affecting so many people in the country, a public hearing be held, the Committee resolved to reconsider the previous Committee report (wherein "educational" had been deleted) and the subject matter discussed, the final revised report to be prepared and formulated after the public hearing and further research.

So much for the Committee meeting. While I am unaware of any public hearing called by the Committee to discuss the matter, the Committee (on

school year 1972-73. The students had organized a very powerful lobby, which was operating in the newspaper offices, the Department of Education, and the halls of the Constitutional Convention.

Taxation and Debt Management) apparently did revise their first report, because the delegates of the Constitutional Convention reported that the word "educational" was in the final draft of the Constitution right up until November 21, 1972, when it was turned over to a style committee. The document underwent a number of revisions and when it was returned to the delegates on November 27, the word "educational" had been deleted. A motion to open the matter for reconsideration was denied.

The most that can be concluded from this brief survey is that there is nothing in the present Constitution (nor was there any intention on the part of the framers of the Constitution) which positively requires the taxation of the land and buildings of private educational institutions.

ARGUMENTS

The local governments (Art. XI, Sect. 5) are given the power to create their own sources of revenue and to levy taxes, subject to such limitation as may be provided by law. At the present time, the limitations on taxing the properties of educational institutions provided by law are the Assessment Law (Commonwealth Act 470) and in certain cases, where a property tax exemption for educational institutions is provided for in the charter of the local government, the Republic Act which created that local government; e.g. R.A. 537 in the case of Quezon City. Article XVII, Sec. 7 of the 1973 Constitution provides that all existing laws not inconsistent with this constitution shall remain operative until amended, modified or repealed by the National Assembly.

While it was not the intention of the Constitutional Convention to positively remove property tax exemption, conceding, however, for the sake of argument that the National Assembly, or the President, by presidential decree⁴ shall decide to repeal the existing laws mentioned above in order to allow local governments to levy property taxes on educational institutions, what would be the purpose? What would be achieved? Or, to look at it another way, assuming no constitutional provision of tax exemption, what reasons are there why a local government may consider granting property tax exemption to private educational institutions located within the territorial limits of that local government?

It is basically through the joint efforts of the parents and the school system of their choice that parents exercise the natural right and duty of rearing the youth for civil efficiency and the development of moral character. The Constitution provides that this natural right and duty of parents shall receive the aid and support of the government. The local government as an instrumentality of the national government may support such effort of parents by either positive assistance or negative assistance, in this case, by the granting of tax exemption on property.

4. As in fact, did happen subsequently, with the issuance of P.D. 261.

A local government frequently gives tax incentives in the form of property tax exemption to encourage industries to locate in their area, thus increasing over-all property values, developing the municipality, creating jobs and providing derivative benefits that come when the salaries from those jobs are spent within the area. While the more common pattern is to grant such exemption for a limited period of time to industrial enterprises to give incentives in the early years of operation until the enterprise "goes over the hump," the trend in many educational institutions today is a growing deficit, which rules out the likelihood of ever "going over the hump."

That such an incentive has had the desired effect in the past is fairly evident. When the Ateneo de Manila University relocated in Quezon City, property values were enhanced, and areas which heretofore were undeveloped were rapidly developed for residential lots, thus increasing the potential for revenue from property tax for the local government. It must be remembered that proximity to schools is one of the factors taken into consideration by a family when choosing the site of their home. Aside from enhancing property values and providing job opportunities and income for the area, the location of a school in an area saves the local government itself from having to provide school facilities for the residents of the area who choose to send their children to that school. [The State shall establish, maintain, and ensure adequate social services in the field of education, health, housing, employment, welfare, and social security to guarantee the enjoyment by the people of a decent standard of living (The Philippine Constitution, 1973)].

In the past, this incentive has been given by Constitutional mandate; the government, on occasion, has even gone further, and *given land* to be used to support educational facilities, e.g., the land grant in Basilan to support the University of the Philippines.

In many localities, the private school facility is looked upon by the people as somehow belonging to them: thus local inhabitants show visitors around the campus of the private school; the local government frequently calls upon the institution for support in the various government projects; the local government can easily make arrangements for the occasional use of the facilities, such as classrooms, gymnasium, and auditorium. Where the campus is spacious, the residents frequently use the campus as a recreational park, which is a facility normally provided by the local government. In time of distress the private school building is used for public purposes to shelter victims of floods, typhoons or fires. Many schools also provide services of a social character such as a social welfare office, an emergency treatment clinic, a placement bureau, etc.

Thus far, we have tried to show the positive reasons why the local government should give an incentive in the form of a property tax exemption to private educational institutions that are located within the territorial limits of the local government.

Should such a property tax be imposed on the grounds of uniform taxation, or of the ability of the institution to pay, this tax would give rise to several problems:

1. What about the school that is already operating at a deficit; should that school institute a special property tax fee in order to pay the assessment? Such a fee will have to be paid by parents who are already being taxed *double*: they pay their taxes, as other citizens do, and should be able to avail of the public educational facilities for their children. For their own reasons, they choose not to avail of these services, and to incur additional expenses in sending their children to private schools; with a property tax fee, they will now in effect be contributing *three times*!
2. With the security of the former constitutional provision of property tax exemption, private educational institutions made their plans accordingly, and did not take into account the implications of a property tax: thus, one educational institution acquired sufficient land not only for its present operation but also for its foreseeable development and expansion; another built substantial improvements, without fear that such improvements would later on be taxed; and another institution decided to remain located in an area of high value real estate, because that area was the most convenient location for its students. Is it fair and equitable to now change the basic and fundamental ground rules under which these institutions made their decisions, and make them subject to a tax on land and buildings?
3. Should the proponents of a property tax attempt to justify it on the basis that the local government needs funds in order to provide essential services, we are in favor of the local government providing such services; but does the local government take into consideration the essential services being supplied by the private educational institutions, and which, if not provided, would become the additional burden of the local government?

Before commenting on the proposed property tax on educational institutions, I wish, then, to reiterate the basic position which has been taken consistently by educational leaders who have given some thought to the requirements of the educational system for the growing population of the Philippines: the government should assist the private educational system, if not through a *positive* program of financial assistance for the reason that at the present time available funds will not permit this, then at least through a *negative* subsidy of tax exemption on property, income, and vital importations.

Assuming, for the sake of argument, that this justification of property tax exemption falls on deaf ears and that the Government in spite of previous commitments and indications, is determined to *narrow* the scope of present tax exemptions, rather than *enlarge* them, the following brief comments are offered:

1. Instead of creating a fourth type of property, the committee of the Department of Finance may want to consider creating not only a fourth, but also a fifth type. The fourth type would be those educational institutions organized on a proprietary basis, which institutions would be subject to a new and preferential assessment value; and the

fifth type would be the non-profit educational institutions, which would remain exempt. This would be consistent with the different treatment accorded these two types of schools in the National Internal Revenue Code.

2. The assessment level should be as nominal as possible; thus the suggested level of 25%, while admittedly preferential over the rate for commercial and industrial corporations, does not, in our opinion, take into consideration the arguments developed in the first part of this paper for complete tax exemption, nor the fact that educational institutions should not be in the classification of industrial and commercial, but, as partners with the government in supplying a required public service, should be totally exempt from property tax, just as the public schools and the University of the Philippines are so exempt from property tax.

While we are reluctant to look upon this as a bargaining situation, if the proposal of the committee is 25% and our proposal is total exemption, an assessment rate of 10 to 15 percent would make the assessment even more preferential and nominal than the committee originally envisioned.

3. We would endorse the proposal of the committee that, after determining the assessment rate, the tax rate to be applied is to be the basic property tax rate only, and will not include the special one percent tax for the special educational fund. The flood control tax is reasonable enough and most schools in the Greater Manila area would be willing to make such a contribution to the government effort to correct and improve the flood control system.
4. We would also endorse the proposal of the committee that the assessment be based only on land and buildings and not on the equipment.

In closing, we should like to thank the committee for the opportunity to present the side of the private educational institutions. Working within the framework that private educational institutions *must* be taxed, the committee has come up with a workable method of assessment that gives some recognition to the contribution of the private educational institutions by using a preferential assessment value. Our petition is that the committee, and the Department of Finance, and the President will consider the long-term advantage to the local government and to the nation of a strong private educational system, basically assisting the Government in providing one of the most essential and costly social services, that of educating the youth and promoting their physical, intellectual, and social well-being, over the short-term gain of taxing these same institutions to provide some added tax revenue for other needed but less important public services.⁵

5. Actually, what has happened subsequently, in addition to the three classifications of property established in P.D. 76 (commercial, agricultural, residential), P.D. 261 set up a fourth and a fifth type of property classification: the fourth type applying to all private educational institutions, both proprietary and non-profit, which are subject to property tax; and the

tax exemption by the Government so that it perforce stands to reason or in equity that the private educational institutions deserve as much, if not more, consideration because education, more than any other form of public service, is dedicated to the development of character, the human and professional skills of the citizenry on which the total development, future progress and strength of the nation ultimately depends; and

4. That in spite of the deletion of the word "educational" in Subsection 3, Section 17 of Article VIII of the 1972 Constitution, which was in fact included in the counterpart provision of the 1935 Constitution (Subsection 3, Section 22, Article VI), this Department believes that there was actually no crystal clear intent on the part of the framers of the fundamental law to tax or disturb whatever form of Government assistance or tax incentives that the private educational institutions did enjoy under the 1935 Constitution.

II. It will be recalled further that the forms of assistance or incentives submitted by this Department, as contained in Section 3 of the proposed Presidential Decree, have been subsequently revised:

a. *Real Property Tax*

In lieu of full exemption, private educational institutions, stock or non-stock, shall be subject to real property tax "at the rates respectively imposed in the locality where such lands or buildings are situated, based on an assessment level not exceeding 15 percent of the fair market value of such real property," with reference to lands and buildings directly, actually and exclusively used for educational purposes; and at the certain rates imposed by the different localities "based on the appropriate assessment level determined in accordance with the provisions of Presidential Decree No. 76," with regard to "lands, buildings and improvements *other than those* directly, actually, and exclusively used for educational purposes."

b. *Income Tax*

In place of full exemption, private educational institutions, stock or non-stock, shall be subject to income tax at the rate of 10 percent on the total net income received during the taxable year, except their passive investment income which shall be taxed at the rate of 10 percent on their gross amount.

c. *Import Duties, etc.*

Private educational institutions shall be entitled to such exemptions as are provided, on any donations of books, equipment, etc. that require no foreign exchange allocations from the Central Bank and are covered by a deed of donation from a foreign donor, subject to the conditions imposed under R.A. No. 1916, as amended.

III. It appears that the proposed Presidential Decree, as revised, had been referred for comment to the (1) National Tax Research Center, (2) Department of Finance, and (3) National Economic Development Authority.

For purposes of this report, the basic recommendations of the three aforementioned agencies are briefly summarized thus —

1. National Tax Research Center

a. *Real Property Tax* — Private educational institutions shall be subject to real property tax "at the specially low assessment level of 15 percent of their fair market value, but exempt the same from the additional real property tax for the Special Education Fund," with respect to lands and buildings directly, actually, and exclusively used for educational purposes; and to the corresponding tax "assessed at the levels prescribed under PD 76" with regard to other real property owned by the private educational institutions not used for educational purposes.

b. *Income Tax* — Payment of income tax "at the preferentially low rate of 10 percent on total net income, except passive investment income."

c. *Import Duty* — Exemption of donated educational equipment, subject to the conditions imposed under R.A. No. 1916, as amended, and in accordance with NEDA Board policy; and non-exemption to non-donated importations.

2. Department of Finance

a. *Real Property Tax* — "That lands and improvements directly, actually, and exclusively used for educational purposes be given the special classification 'educational' to distinguish them from any of the classifications prescribed under Presidential Decree No. 76, and that a preferential assessment level of twenty *per centum* (20%) of their current and fair market value as determined by the assessor be prescribed for both lands and buildings or other improvements."

In addition, an additional real property tax of one-eighth ($\frac{1}{8}$) of one *per centum* (1%) of the assessed value of the property is proposed to accrue to the Greater Metropolitan Manila Area Flood Control and Drainage Fund Account created under Presidential Decree No. 18, if the property is located within the Metropolitan Manila area.

b. There is no objection to the recommendation submitted by the National Tax Research Center with respect to *income tax* and *import duties*.

3. National Economic Development Authority

In general, "xxx no preferential treatment in terms of lower tax base and no exemption from the payment of taxes."

COMMENTS

a. *On the Real Property Tax*

This Department believes that the supposed "specially low assessment level of 15 percent of fair market value," proposed to be imposed on lands, buildings, and other improvements which are used directly, actually,

and exclusively for educational purposes may still be taken too onerous or burdensome to the private educational institutions, and moreover, the additional tax burden may not be to the advantage of the nation in general and to the school system in particular.

The private educational institutions are essentially dependent on tuition and other school fees for their operation and support, which is currently regulated in accordance with R.A. No. 6139. On the other hand, this Department, pursuant to Act No. 2706, as amended, prescribes the standards which the private schools shall observe and comply with relative to school site, buildings, and facilities, among others, in order for them to at least provide adequate education to the public and/or to attain and maintain the desired efficiency of instruction.

It is evident, therefore, that the additional cost in the operation of the private educational institutions brought about by the new tax burdens, if approved, may be justifiable reason for said schools to increase their fees or charges, if they are to survive.

With tuition fees as the principal source of income and/or support for the private educational institutions, the real property tax may likely be shifted to the students and/or their parents in the form of increased school fees, or it may even force the private schools to stop operations because of the gnawing reality that they will then be made to shoulder the new tax burden whether they gain profit or lose in their operations.

As expressed by the Department of Finance, concurred in by the National Tax Research Center, the proposed real property tax on private educational institutions shall be a source of income for the local governments. Thus, the National Tax Research Center estimates that the proposed real property tax in Greater Manila may raise an additional amount of ₱3.4M (Yoinco Report, p. 4). This Department would like to stress the fact that the estimated amount to be raised pales into insignificance when compared to the capital of ₱249M invested by the private educational institutions in the same area (Table 4, Yoinco Report), which the Government should otherwise have to provide in order to carry out the provision of the Constitution that "*the State shall establish, maintain and ensure adequate social services in the field of education xxx*" (Sec. 7, Art. VII).

Accordingly, this Department reiterates its position that the private educational institutions, stock or non-stock, be accorded full exemption from real property taxes, as originally recommended, except the tax called for under Presidential Decree No. 18. This position is deemed to be fair and reasonable since there is at least a consensus that the private educational institutions have given significant contributions "to the government efforts to educate the youth and develop strong moral character," which should be given due recognition. Moreover, such a policy is not really peculiar nor isolated, for as aptly stated by the National Tax Research Center, through Mr. Yoinco, tax exemptions to "educational institutions and activities" are in fact observed and practiced in other countries like India, Japan, Australia, United States of America, United Kingdom, and France (Yoinco Report, p. 5).

b. On Income Tax

Following the theory of *destination*, instead of the *source* theory,⁶ this Department had originally recommended full exemption to the private educational institutions, stock or non-stock, from income tax, subject to two (2) limitations, namely, (1) a *ten per centum* tax on income distributed to any stockholder or individual, and (2) the regular corporate tax on income from unrelated trade or business.

Realizing the need to impress upon the private educational institutions the reality that they are part of the system and it is their bounden duty to share in the support of the operations of the Government, this Department is inclined to agree with the proposal to subject the private educational institutions to pay income tax at the rate of ten percent of their *total net income*. This Department, however, holds the view that the proposed 10 percent income tax on the passive investment income of the private educational institutions should likewise be reckoned against their *total net income* instead of their "*gross amount*."

If the private educational institutions must be taxed on their income, this Department submits that there should be no compartmentalization into school income (net income of which is to be taxed) and *passive investment income*⁷ (gross income of which is to be taxed). This Department believes that to tax the gross income from dividends, interest, etc., without taking into consideration the deduction allowed even to the ordinary commercial business enterprises is no incentive at all, is discriminatory, and it will negate the oft-repeated Government recognition to be given to private education in this country. If passive investment income is to be taxed, this Department proposes that it be combined with the school operation, so that at least some relief might be given by allowing

6. Prior to 1947, the criterion for whether income of non-profit institutions was exempt from tax was the use (destination) to which this income was placed. Provided it was used to further the objectives of the institution, the income was exempt from tax, regardless of the source, whether it was income derived from its activities, or income from real or personal property.

After 1947, with the adoption of the present wording of Section 27(e) of the National Internal Revenue Code, even if income is destined for the objectives of the institution, only that income derived from its activities is exempt; "... 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 this Code."

7. Passive investment income, in general, refers to income derived from real or personal property, such as interest, dividends, and possibly rental income, with the added nuance that the institution does not expend any time or effort nor incur any added costs to receive such income. The term is not found in the present National Internal Revenue Code; the concept has been used in several rulings by the Bureau of Internal Revenue.

a school operating loss to be offset by passive investment income. Conditioned on this treatment of passive investment income, the net effect would be that all private educational institutions, including non-profit schools, will be taxed 10% on their overall net income, as presently provided for in Section 24 of the NIRC, thereby eliminating non-profit educational institutions from the ambit of Section 27(e) thereof, which consequently would eliminate all differences between the two types of private educational institutions.

c. On Import Duties

There should be no distinction between donated and non-donated items in the matter of importation of essentially needed facilities by private educational institutions. However, realizing the need for some measures of control and in order to assure consistency in the implementation of existing policy regarding importation of school facilities, this Department proposes that the importations be limited to items that are not available locally at competitive prices, and that such importations shall invariably be made in accordance with the rules and regulations to be established by the NEDA.

RECOMMENDATIONS

Premises considered, this Department hereby recommends the following:

1. That as originally recommended, the private educational institutions be granted incentives in the form of full exemption from real property tax as well as taxes computed on values based on lands, buildings and improvements thereon which are actually, directly and exclusively used for educational purposes; except the tax called for under Presidential Decree No. 18, for the Greater Metropolitan Manila Area Flood Control and Drainage Fund Account.

2. That the computation of the school income and passive investment income of the private educational institutions be made uniform based on their *total net income*.

3. And that there should be no distinction in school importations into donated or non-donated categories; provided, however, that the importations shall be limited to items or school facilities which are not available locally at competitive prices, and that such importations shall invariably be made in accordance with the rules and regulations to be prescribed by the NEDA.

(Sgd.) *Juan L. Manuel*
Acting Secretary

DOCUMENT 4

Presidential Decree No. 304. Further Amending Presidential Decree No. 76 As Amended by Presidential Decree No. 261 by Extending the Date of Accrual of the Basic Tax on Real Property Actually, Directly, and Exclusively Used by the Owner Thereof for Educational Purposes.

Whereas, in accordance with the provisions of the new Constitution, real property used exclusively for educational purposes are no longer among those exempted from the real property tax;

Whereas, under the provisions of Presidential Decree No. 261, which amended Presidential Decree 76; all lands, buildings and other improvements thereon actually, directly and exclusively used by the owner thereof for educational purposes shall be subject to the payment of the real property tax at the rate prescribed thereon, effective January 1, 1974;

Whereas, educational institutions have made representations that they be given sufficient time to adjust their financial plans in order that they may be able to provide adequate funds for the prompt payment of real property taxes;

Now, therefore, I, Ferdinand E. Marcos, President of the Philippines, by virtue of the powers vested in me by the Constitution as Commander-In-Chief of all the Armed Forces of the Philippines, and pursuant to Proclamation No. 1081, dated September 21, 1972, as amended, do hereby decree and order that:

1. The realty tax on real property actually, directly, and exclusively used by the owner thereof for educational purposes as prescribed under Presidential Decree No. 261 shall begin to accrue on January 1, 1975 instead of January 1, 1974.

2. Such real properties shall be listed and assessed for taxation purposes during the calendar year 1974 on the basis of fifteen percent (15%) of their current and fair market values as amended by Presidential Decree No. 76, as amended by Presidential Decree No. 261.

This Decree shall form part of the laws of the land and shall take effect immediately. All laws, orders, rules and regulations which are inconsistent with this Decree are hereby repealed or modified accordingly.

Done in the City of Manila, this 2nd day of October, in the year of our Lord, nineteen hundred and seventy-three.

(Sgd.) *Ferdinand E. Marcos*
President of the Philippines

DOCUMENT 5

Presidential Decree No. 305, Amending Certain Sections of the National Internal Revenue Code Governing Educational Institutions.

Whereas, under existing law, educational institutions are not placed at par for taxation purposes as some are subject to tax others are not subject to tax;

Whereas, in line with the provisions of the New Constitution removing the exemptions of educational institutions from real estate taxes, their exemption from income tax should likewise be removed, as provided under existing laws;

Whereas, to achieve simplicity in implementation, there should be imposed a fixed rate of tax on all income of educational institutions;

Whereas, in order to achieve improvements in educational facilities and expansion of educational activities, the reinvestment of profits or surplus necessary therefrom should be encouraged.

Now, therefore, I, Ferdinand E. Marcos, President of the Philippines, by virtue of the powers in me vested by the Constitution as Commander-In-Chief of all the Armed Forces of the Philippines and pursuant to Proclamation No. 1081 dated September 21, 1972, as amended, do hereby order and decree that certain sections of the National Internal Revenue Code as amended, be further amended, to read as follows:

Sec. 24. Rates of Tax on corporations — (a) Tax on domestic corporations.

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Private educational institutions, whether stock or non-stock shall pay a tax of ten percent of their taxable net income from the operation of the school, related school activities, and on their passive investment income consisting of interests, dividends, royalties, and the like; *Provided*, however, That dividends received by a private educational institution, whether stock or non-stock, from a domestic or resident foreign corporation shall be subject to the partial exclusion of intercorporate dividends provided under Section 29 (c) of this Title, under the conditions imposed in the said subsection.

xxxxxxxxxx

Sec. 27. Exemption from tax on corporation. xxx

(e) Corporation or association organized and operated exclusively for religious, charitable, scientific, athletic or cultural 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.

However, the income of any of the foregoing organizations of whatever kind and character from any of their 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 this title.

Sec. 30. *Deductions from gross income. xxx*

(a) *Expenses:*

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(4) *Expenses allowable to private educational institutions.*

In addition to the expenses allowable as deductions under paragraph (1) of this sub-section, a private educational institution, whether stock or non-stock, shall also be allowed to deduct during the taxable year when incurred expenses for the expansion of school facilities to be determined by rules and regulations issued jointly by the Department of Education and Culture and Finance.

This Decree takes effect beginning the calendar year 1974 and fiscal year beginning July 1, 1974.

Done in the city of Manila, this 2nd day of October, in the year of Our Lord, nineteen hundred and seventy-three.

(Sgd.) *Ferdinand E. Marcos*
President of the Philippines

DOCUMENT 6

Assessment of Presidential Decrees 304 and 305.

Prepared by Father Thomas R. Fitzpatrick, S.J., for a conference of school administrators in November 1973.

On October 8, 1973, the representatives of COCOPEA (Coordinating Council of Private Educational Associations) were called to a conference by the Secretary of Education to discuss two new Presidential Decrees, P.D. 304 and 305. While the obvious intention of such a meeting was to obtain the comments of the representatives of the educational associations, the two decrees given us clearly indicated that they had already been signed into law on October 2, 1973 by the President.

The background for these decrees is quite extensive. The best single summary of the most recent background is the memorandum of the Secretary of Education to President Marcos, dated April 4, 1973. The stand taken by the Secretary of Education in that memorandum was that private educational institutions should remain exempt from property tax; and, all private educational institutions, both *non-profit* and *proprietary*, or, in the words of the decree, *non-stock* and *stock*, should be subjected to a ten percent tax on their net income on overall operations. "Overall operations" consists of the school operations as such, together with the transactions usually listed under "other income and expenses" in which is included income from real and personal property.

From the two decrees, it is clear that the advisers of the President have chosen to depart from the recommendations of the Secretary of Education. The recommendations of the Secretary, in my opinion, were implicitly a "package," i.e., must be taken as a whole, and not separately.

The imposition of a ten percent income tax on the overall operations of all schools which was recommended by the Secretary, based on his first recommendation that no property tax be imposed, has been imposed *together with* the property tax.

Thus, non-stock (non-profit) schools, which before were subject to neither property tax nor income tax on school operations, are now subject to two new taxes. Stock schools are now subject to only one new tax, the property tax, since they have always been subject to a 10% tax on overall income.

Stock schools may also see some further relief in the provision of P.D. 305 which allows as a deduction those expenses incurred for the expansion of school facilities, to be determined by rules and regulations issued jointly by the Departments of Education and Culture and Finance. Non-stock schools will not at this time appreciate the meaning of this deduction.

If the above analysis is correct, then this would explain why the measures contained in the two decrees will, in general, be received favorably by the stock institutions and unfavorably by the non-stock, non-profit institutions.

So much for the general background; in the detailed analysis which follows, primary attention is given to the substantive measures contained in the decrees; some attention, however, is given to the "Whereas clauses" of both decrees, since these clauses generally set forth the prevailing philosophy and rationale that support the particular measures.

PRESIDENTIAL DECREE 304

This decree is consistent with the position taken by President Marcos on several occasions to suspend the effect of the property tax on educational institutions for at least one year. For this, the schools should be grateful. The decree, however, does not give any indication how the schools will be able to adjust their financial plans in order to pay the property tax. The most obvious way is by lifting the tuition freeze. By issuing this decree at this particular time, the conclusion could be drawn that it was issued to forestall a concerted effort on the part of the private schools to have the government lift the tuition freeze for school year 1974-75.

In summary it might be said that from the government's point of view, this decree allows the government some time before lifting the tuition freeze; from the point of view of the private educational institutions, it postpones the payment of the property tax for at least one year; and it gives added time to accomplish the following:

- develop a position that *all* schools continue to be exempt from property tax, based on the recent COCOPEA survey, where results show that for every one peso a year the government can hope to raise, the schools already support their own operations with more than one hundred times that amount;

- develop a position that *some* schools (non-profit schools, arguing from P.D. 261 which exempts educational foundations under R.A. 6055) should enjoy property tax exemption;
- develop a position that *at least* mission schools should be exempt; or
- develop a position that the property tax should not be implemented until such time as the tuition freeze is lifted.

There is no need to discuss at any length the faulty conclusion made in the first *Whereas* clause of the decree. The fault in the clause is that it seems to conclude that in accordance with the provision of the New Constitution, real properties used exclusively for educational purposes are no longer among those exempted from the real property tax. An understanding of the intent of the Constitution would show that it was not the intent of the Constitution to *positively subject* such properties to taxation, but merely to remove such properties from the protective mantle of the Constitution as regards taxation; the Constitution left it open whether such an exemption would or would not be granted by the National Assembly; in fact, until some positive act removed the exemption previously given by positive law, i.e., Commonwealth Act 470, which granted tax exemption in conformity *with* but not *by virtue of the* Constitution, the property tax exemption remained for educational institutions; it is clear that such an exemption, which continued after the New Constitution, was removed by P.D. 261. It is clear that property tax exemption can still be granted by the National Assembly or by Presidential Decree, as in fact is done in P.D. 261 as regards those educational institutions organized as educational foundations under R.A. 6055.

I have made such extended remarks to clear up the mistaken notion that might be conveyed in the first *Whereas* clause of P.D. 304: that the new Constitution *positively requires* the subjection of educational properties to property tax. I repeat: the protective mantle of the Constitution as regards property tax is removed in the New Constitution, and it is left to the National Assembly (or Presidential Decree) to decide whether such properties continue to enjoy such exemption or to take such exemption away, or to modify it. Unless this point is established, it is futile to work toward the exemption of such properties, if the mistaken notion prevails that the New Constitution *requires* educational properties to be subject to taxation.

PRESIDENTIAL DECREE 305

Out of the four introductory *Whereas* clauses to this decree, I feel that some comment should be made on the first two clauses.

It appears that implicit in the first clause is the old argument: why should some schools be subject to (income) tax, and others not subject to (income) tax, as though this difference in tax treatment were somehow discriminatory. The basis for the difference of treatment is one of corporate structure: some institutions are organized as stock corporations, and within that structure are allowed to distribute dividends; whereas other

institutions are organized as non-stock, non-profit, and within that structure are not allowed to distribute dividends or benefit any private individual. The difference in tax treatment, then, was based on a difference in corporate structure; such a different treatment was not then *discriminatory*. The government must still see some value in the non-stock, non-profit structure, since in P.D. 261, it gives a tax incentive, exemption from property tax, to those educational foundations organized under R.A. 6055, which are basically non-stock, non-profit institutions. Thus, the first clause gives no rationale or basis for imposing taxes on non-profit educational institutions.

The second clause appeals to the parallelism between this decree and the new Constitution: just as the new Constitution removes the exemption of educational institutions from real estate taxes, so this decree should remove their exemption from income tax. This reasoning labors under several difficulties.

I will not repeat the position I gave previously in this paper regarding what the new Constitution does as regards the exemption from property tax. But from the Constitution, which merely removes the protective mantle of the Constitution, and leaves it to the National Assembly whether to grant or take away an exemption, no valid argument may be derived for taking away the exemption from income tax as provided under existing laws.

Secondly, if it is argued that it is in line with the new Constitution to remove exemptions of educational institutions (and not, as I say, of removing the protective mantle of the Constitution from subjecting such properties to taxation), then it might be added: by what right does the President, in P.D. 261, grant property tax exemption to educational foundations? Surely, he is not doing so in violation of the new Constitution. The President's own action in P.D. 261 demonstrates the very point I have attempted to make: the Constitution does not require that educational institutions be subject to property tax; but leaves it to the National Assembly to decide whether to subject to, or exempt from, taxation. Any argument from the Constitution should then conclude, as regards taxation on income, that it is up to the National Assembly to subject to, or exempt from, taxation on income. The Constitution should not be used as a reason or defense for taking away the exemption from tax on income.

The fourth *Whereas* clause has the expressed purpose of encouraging *improvements* in educational facilities and expansion of educational *activities*. These purposes used to be achieved by the tax-exemption on income given to non-profit educational institutions. The only segments, therefore, which have received new incentives for improvements and expansions are those segments previously subject to tax where such expenditures could not be deducted, i.e., the stock schools as regards all income, and the non-stock schools as regards income from real properties.

I wish to point out what seems to be a very serious omission in the amendment of Sec. 30, a) 4. The *Whereas* clause encourages "improvements in facilities and expansion of educational activities;" this is compressed to read "expenses for the expansion of school facilities" in the body of the

decree. Unless this is corrected, it may work to defeat the very purpose of the incentive. We may not need *expanded facilities*; most agree that we need *improved* facilities, and *expanded* educational activities.

DOCUMENT 7

Letter of Secretary Cesar Virata

Text reprinted from the Philippine Sunday Express, 21 April 1974.

Dear Friends:

Numerous letters written to the President, the First Lady, Mrs. Imelda Romualdez-Marcos, and the department of finance have taken issue with the reasonableness of taxing private schools.

Let me assure you that the taxation of private schools is mandated by the new Constitution of the Philippines and by Presidential Decree No. 305. The intent of the Constitution and the various Presidential Decrees on taxation of private schools is not to make education more expensive for the parents and children nor even to force some schools to close. The intent of the Constitution and the new laws rather is to improve the standards of education so that everybody, rich and poor alike, will have equal opportunity to benefit from a modern and high standard of education.

I. On Realty Tax

Under Article VIII Section 17 (3) of the new Constitution of the Philippines, lands, buildings and other improvements actually, directly and exclusively used for educational purposes are no longer exempt from the payment of real property tax.

This new provision of the new Constitution is an expression of the will of the people, for the delegates who framed our Constitution were elected by us. Recognizing the idea of equally sharing the burden of taxation among all who benefit from taxes, the delegates decided to remove the exemption enjoyed by educational institutions from the payment of real property tax.

However, President Marcos has promulgated several decrees to lighten the impact of taxes imposed on the educational institutions. One such decree was Presidential Decree No. 261 classifying lands occupied by educational institutions under a special class, thus lowering the basis of the tax imposed on them.

Where the realty tax on residential lands is based on 15% to 30%; agricultural land on 40%; and commercial and industrial land on 50% of the current and fair market value, realty tax on land for educational purposes is based only on 15% of the current and fair market value pursuant to Presidential Decree No. 261. For example, if the value of the land is ₱50/sq.m., the tax base is 15% of ₱50 or ₱7.50/sq.m. and the tax of 1% is 7½ centavos per year per square meter. In 1975, when the realty

tax will be imposed an additional discount of 15% is allowed, hence they will pay only 6 $\frac{3}{8}$ centavos per square meter.

The same decree also exempts land for educational purposes from the payment of the 1% Special Education Fund tax. On the other hand, the other types of lands are subject to the payment of said 1% Special Education Fund tax.

Local governments depend a great deal on real estate taxation for their revenues. In turn, such revenues provide services to the community. There is no doubt that schools need such services provided by local governments such as police protection, fire fighting equipment, garbage collection, road improvements, drainage, health facilities, etc. We have observed also that many schools, especially religious schools, have paid imputed rents and charges to the religious orders.

II. On Income Tax

Presidential Decree No. 305 requires private schools to file income tax returns in line with the provisions of the new Constitution. Under this Decree, private educational institutions, whether stock or non-stock, shall pay a tax of only 10% of their taxable net income from the operation of the school, related school activities, passive investment income consisting of interests, dividends, royalties and the like. Please bear in mind that the tax is fixed at only 10% as against the taxes paid by other corporations which is at the rate of 35%.

Generally speaking, good schools do not have any profits; they provide more school services than the tuition fees paid, hence, they are not bothered by income taxes. The Government believes that if a school has surplus income and does not use it for the benefit of the school it should be taxed. In turn, this tax income can be used to support public education. As you know, about 30% of the total current expenditures of government goes to education.

As provided in the decree, outlays for the expansion or improvement of school facilities can be deducted from the taxable income of the school. A school which spends a good portion of its income for the expansion of the school and for the improvement of its learning facilities need not worry about payment of income tax because of the deduction allowed. Hence, this tax policy on private schools will eventually result in reinvestment in school facilities and hopefully a higher standard of education.

Taxes are everybody's concern. This is the main revenue of the government, as fees are to schools and as wages are to workers. Taxes are spent for general welfare, especially for defense, security, health, and education, as well as for many other services demanded by the poor people particularly. The Constitution also stipulates that taxation must be progressive — those who have higher incomes must pay more taxes.

You will note that private educational institutions enjoy a lower tax levy than all other sectors in recognition of the special role that educational institutions play in the development of an enlightened and responsible citizenry. Taxation, as we all know, is an instrument for guiding national

activities and for collecting revenues which are then spent for general public welfare.

(Sgd.) Cesar Virata
Secretary of Finance

DOCUMENT 8

Draft of Letter Replying to Secretary Virata.

Draft prepared by Father Thomas R. Fitzpatrick, S.J., in April 1974

Dear Secretary Virata:

We should like to comment on the text of a poster from the National Media Production Center dated April 5, 1974, bearing your signature, which also appeared in the *Philippine Sunday Express* for April 21, 1974.

Your letter first of all gives the clear impression that taxation of private schools is mandated by the New Constitution, and that the removal of the exemption from property tax "is an expression of the will of the people, for the delegates who framed our Constitution were elected by us."

This may be the way you see it. However, may we invite your attention to the reasoning and conclusion made in the first part of the enclosed position paper⁸ with slight revisions:

... The Committee (on Taxation and Debt Management) apparently did revise their first report, because the delegates of the Constitutional Convention reported that the word "educational" was in the final draft of the Constitution right up until November 21, 1972, when it was turned over to a style committee. The document underwent a number of revisions and when it was returned to the delegates on November 27, the word "educational" had been deleted. A motion to open the matter for reconsideration was denied.

The most that can be concluded from this brief survey is that there is nothing in the present Constitution (nor was there any intention on the part of the framers of the Constitution) which positively requires the taxation of the land and buildings of private educational institutions.

It is not denied that once the mantle of the Constitution was removed, it is now within the power of the National Assembly, or at the present time, within the power of the President by Presidential Decree, to impose property taxes on private schools; but this is imposed by virtue of legislative intent and not by constitutional mandate.

What we should like to insist on, and which point has been lost sight of, is that there is nothing in the Constitution which mandates the taxation of private educational institutions. If this were so, then President Marcos, in

8. The position paper referred to is the paper that appears in this Special Report as Document 2.

P.D. 261, in which tax exemption is granted to private educational institutions organized as foundations, would have been acting *ultra vires* and contrary to the Constitution. In this instance, the practice of the government confirms the very point that we are trying to make.

The next point we should like to comment on in your letter is the statement that property tax enables the local government to provide essential services to the educational institutions. This may have some validity in theory, but it certainly has not been realized in practice in regard to various educational institutions. There is appended a report from one institutional member of our association, which demonstrates that none of the services mentioned are provided by the local government (Appendix "A").

Furthermore, your rationale seems to take no cognizance of the public service being rendered by the school, at least on behalf of those who live in that division of the government where the school is located, and of the benefits derived by the local government. Some of these benefits are enumerated in the position paper prepared by the Catholic Educational Association of the Philippines and already forwarded to the Department of Finance.⁹

We are somewhat puzzled by your observation that many schools, especially religious schools, have paid imputed rentals and charges to the religious orders. The observation does not support the immediately preceding statement. The charging of rentals, or some form of use-cost of the building and/or land not owned by the school, would seem to be a legitimate cost. Should this rental be actually paid to some other entity, and not merely imputed, there has been nothing in the past to prevent the BIR from assessing that entity for rental income.

Was the intent in including the above observation to give the impression that the schools were doing anything reprehensible and therefore should now be punished by being subject to tax? If this is the case, the proper remedy would be to assess the rental income for the proper tax.

Further on, you state "that good schools do not have any profits, and if they do have surplus income and do not use it for the benefit of the school, it should be taxed." Inherent in the concept of a non-profit school is the idea that surplus income (profit) be used for the benefit of the school. It is the responsibility of the Board of Trustees to see that this is done. Aside from the expansion and improvement of facilities mentioned in Decree 305 [which will be allowed as deductions during the taxable year in which incurred in accordance with rules and regulations to be issued jointly by the Departments of Education and Culture and Finance], there are a number of other expenditures which must be covered by the surplus income and yet which may not be shown as deductions from surplus income either for reporting or tax purposes. Some of these expenditures are as follows:

- books and equipment to the extent that these are not provided for

9. See above, Document 2.

by depreciation on books and equipment. The depreciation, based on historical costs, does not ordinarily provide the necessary amount for replacement.

- repayment of principal amount of debts.
- setting aside a reserve from surplus income over a number of years in order to be able to finance a major improvement in one particular year.

In the case of these expenditures, the surplus income may be used entirely for the benefit of the school, not necessarily in the year in which the income was derived, but at least within a reasonable period. And yet this surplus income is going to be taxed, as though it were not benefiting the school.

Because the present tax procedures make no provision for an operating loss carry-over, surplus income for one year which may be needed to cover the operating deficit of the previous year, and which is therefore used to benefit the school, will likewise be subject to tax.

In conclusion, we would like to assure you that we share your concern about taxes. We are also concerned as you are about improving the standard of education, and can only view the measures taken as inhibiting our efforts to do so. It is in this light that we have commented extensively on your letter and proposed these comments for your serious consideration.

APPENDIX "A"

In regard to *road improvements and lighting*: the school has constructed its own road system and has installed its own street lighting system at its own expense.

In regard to *police*: the school maintains its own campus security force at an outlay of approximately ₦60,000 a year which is ultimately paid for by the students and parents. To cite an experience from last year: a burglar was caught in the student resident area, and held by our security force. After trying for more than one hour to call the city police [the precinct reported that there was no police jeep available], the burglar was conveyed to the local precinct by a school administrator in a school car.

In regard to *garbage collection*: at no time has the city offered this service. At the present time, we have hired a private garbage collection agency to handle this task at a cost to the University (and ultimately to the students and parents) of ₦15,000 a year.

In regard to *health facilities*: by regulation of the Bureau of Private Schools, private schools are required to maintain their own facilities and their own medical staff, depending on the size of the student enrollment.

As regards *drainage*: the expenses for this are either paid for by the private school, or if provided by MWSS, are included in the billing for their services.

In summary, the services provided by the city government are, at least in the case of our institution, minimal; it is really up to other institutions to say whether the same holds true in their institutions.

DOCUMENT 9

Excerpt from Draft of The Private Education Code.

Draft prepared by the Department of Education and Culture, May 1975.

CHAPTER III
INCENTIVES TO EDUCATIONAL CORPORATIONS

Article 199. *Policy.* It is the policy of the State to encourage and foster the improvement and stabilization of authorized private schools by inducing them through appropriate tax incentives as provided for in this Chapter to invest in teaching and research facilities, to devote their funds to implement specific projects directly aimed at promoting scholarship, to improve and further develop the quality and depth of education in harmony with the national developmental goals, and to seek membership in recognized accreditation associations as allowed under this Code.

Article 200. *Property Tax.* Private school operations irrespective of classification which are duly authorized to operate courses pursuant to the provisions of this Code, shall be exempted from the payment of the basic real property tax as well as other taxes computed on values based on land, buildings, and other improvements thereon, which are directly and exclusively used by them for educational purposes. However, land, buildings, and other improvements thereon of private school corporations, which are not directly and exclusively used for educational purposes shall be subject to the basic real property tax, together with such other additional taxes as provided for under existing laws.

Article 201. *Income Tax.* Private school operations irrespective of classification duly authorized to operate courses pursuant to the provisions of this Code shall enjoy full exemption from the payment of income tax:

(a) on their income of whatever kind and character derived from operation, and school related activities as may be owned and operated by them, such as, but not limited to, dormitories, cafeterias and canteens, book-stores, transportation services, which are all organized primarily to serve their school population, including income from vocational shops and such other activities, which are primarily organized to train students on essential products to be used in school operations, provided that such income shall be used exclusively and directly for the school in furtherance of its expressed objectives; and

(b) on their income of whatever kind and character such as interest, dividends, capital gains, and other similar income derived from passive investments or property, provided that such income shall be used directly and exclusively for school development programs such as the improvement of school facilities, or indirectly through the establishment and growth of endowment funds, both the ownership and income of which shall also be used exclusively for the school. Private schools organized as stock corporations shall be subject to the payment of the regular income tax of ten percent as provided for under existing laws on all income distributed by way of cash dividends to stockholders.

Article 202. *Import Duty.* Private school operations duly authorized to operate courses pursuant to the provisions of this Code shall enjoy full exemption from import duties, compensating tax, and other charges on, or in connection with, all donations consisting of equipment, building materials, books, publications and documents, as well as educational, scientific and cultural materials as listed in the pertinent annexes of the United Nations Educational Scientific Cultural Organization agreement to which the Philippines is a party; provided that the donations shall require no foreign exchange allocation from the Central Bank and are covered by corresponding deeds of donation from the foreign donor. All importations of items as listed under the applicable annexes of the UNESCO agreement, even when foreign exchange is required and has been allocated by the Central Bank for the payment of such importations, shall likewise be exempted from customs duties, compensating tax, and other charges in connection with such importations, upon certification by the Secretary of Education and Culture that such articles are imported solely for the educational purposes of the school.

The conditions set forth in paragraph one of Section 105 of the Tariff and Customs Code of the Philippines shall be observed and complied with.

In accordance with the UNESCO agreement, the exemptions herein provided shall not prevent the levying on such importations of:

(a) internal taxes or any other internal charges of any kind, imposed at the time of importation or subsequently, not exceeding those applied directly or indirectly to like domestic products; and

(b) fees and charges, other than customs duties, imposed by the government on, or in connection with, importation which shall be limited in amount to the approximate cost of the services rendered and representing neither an indirect protection to domestic products nor a taxation of imports for revenue purposes.

The Secretary of Education and Culture, in coordination with the Secretary of Finance and the Director-General of the National Economic Development Authority, shall promulgate the rules and regulations to implement this provision.

Article 203. *Conversion of Stock Corporations into Non-Stock Corporations.* Private schools organized as stock corporations shall be encouraged to convert themselves into non-stock corporations. For this purpose, stockholders of the stock corporate school may be paid for their shares on the basis of the net worth of the stock corporation, at book value as adjusted for any reappraisal surplus as may be determined by independent appraisers or on the basis of property assessments. Payment to the stockholders may be made over a reasonable period of time at a reasonable rate of interest out of any surplus that the resultant non-stock corporation may generate from its operation after its conversion, provided that the financial viability and academic quality of the school shall not be prejudiced. Pending full payment of the agreed value of their shares of stocks, the former stockholders may have first lien on the general assets of the resulting non-stock corporation. Any capital gain resulting from the arrangement that the former stockholders may be liable for will be subject

to fifty percent of the normal income tax; provided that if an amount equivalent to the income tax that would have been due is donated back to the non-stock corporation, the former stockholders shall be completely exempt from all taxes on capital gains and donations that may otherwise be levied.

In order that the tax benefits under this Article may be properly availed of, such application for conversion shall have the prior approval of the Secretary of Education and Culture, who shall promulgate such rules as may be necessary for the purpose, in consultation with the Secretary of Finance and the Secretary of Trade.

Nothing in this Article shall be construed as mandatory for stock corporations to convert themselves into non-stock corporations.

CHAPTER IV LIMITATIONS

Article 204. *Prohibited Transaction.* Any private school corporation that avails of the tax incentives as provided for in this Code is strictly prohibited from affecting any substantial purchase of securities or any other property for more than an adequate consideration in money or money's worth, or selling or otherwise transferring any substantial part of its securities or other property for less than an adequate consideration in money or money's worth.

Article 205. *Imported Equipment or Materials; Sale or Transfer.* Any equipment, building materials, books, publications and documents, imported by any private school for educational purposes pursuant to the provisions of this Chapter shall not be sold, bartered, leased, or hired for other than educational purposes. In case such articles are subsequently conveyed or transferred to other parties for a pecuniary consideration, the taxes and duties therefore shall be collected at double the rate provided for under existing laws, payable by the transferor.

Article 206. *Penalty Clause.* Any violation of the provisions of this Chapter shall be considered unlawful and shall subject the violator to the general penalty clause and/or administrative sanctions as provided for in this Code.

CHAPTER V INCENTIVE TO INDIVIDUAL TAXPAYERS

Article 207. *Allowable Deduction from Gross Income of Individual Taxpayers.* Educational expenses incurred for tuition fees paid to private schools by any taxpayer during the taxable year for the education of his dependents as defined in Section 23(c) of Commonwealth Act. No. 466, as amended, shall be allowed as full deductions from gross income under Section 30(a) of the same Act, provided that the maximum deduction allowed shall be one hundred and twenty pesos for each dependent

studying in the second level, and five hundred pesos for each dependent in the third level, that such deductions shall be recognized only if each dependent was enrolled with at least a normal study load for the entire school term, and that not more than four dependents shall be allowed for each taxpayer as deductions for the taxable year.

In connection with claims for deductions under this Article, the taxpayer shall furnish the name and date of birth of each dependent for whom the expense was incurred during the taxable year, as well as the amount and the date of actual payment thereof in each case. Claims for deduction must be substantiated by official school receipts indicating the amounts actually paid for tuition fees.