Republic of the Philippines
Supreme Court
Baguio City

THIRD DIVISION

MEDICARD PHILIPPINES, INC.,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

G.R. No. 222743

Present:

VELASCO, JR., *J.*,
Chairperson,
BERSAMIN,
REYES,
CAGUIOA,* and
TIJAM, *JJ.*

Promulgated:

April 5, 2017

Mis-PDC Batt

x----------x

DECISION

REYES, *J.*:

This appeal by Petition for Review[1] seeks to reverse and set aside the Decision[2] dated September 2, 2015 and Resolution[3] dated January 29, 2016 of the Court of Tax Appeals (CTA) *en banc* in CTA EB No. 1224, affirming with modification the Decision[4] dated June 5, 2014 and the Resolution[5] dated September 15, 2014 in CTA Case No. 7948 of the CTA Third Division, ordering petitioner Medicard Philippines, Inc. (MEDICARD), to pay respondent Commissioner of Internal Revenue (CIR) the deficiency

---

* Additional Member per Raffle dated April 3, 2017 *vice* Associate Justice Francis H. Jardeleza.

1 *Rollo*, pp. 187-231.

2 Penned by Associate Justice Juanito C. Castañeda; id. at 13-45.

3 Id. at 46-59; Presiding Justice Roman G. Del Rosario with Concurring and Dissenting Opinion, joined by Associate Justice Erlinda P. Uy.

4 Penned by Associate Justice Ma. Belen M. Ringpis-Liban, with Associate Justices Lovell R. Bautista and Esperanza R. Fabon-Victorino concurring; id. at 124-174.

5 Id. at 175-178.

Value-Added Tax (VAT) assessment in the aggregate amount of ₱220,234,609.48, plus 20% interest *per annum* starting January 25, 2007, until fully paid, pursuant to Section 249(c)[6] of the National Internal Revenue Code (NIRC) of 1997.

The Facts

MEDICARD is a Health Maintenance Organization (HMO) that provides prepaid health and medical insurance coverage to its clients. Individuals enrolled in its health care programs pay an annual membership fee and are entitled to various preventive, diagnostic and curative medical services provided by duly licensed physicians, specialists and other professional technical staff participating in the group practice health delivery system at a hospital or clinic owned, operated or accredited by it.[7]

MEDICARD filed its First, Second, and Third Quarterly VAT Returns through Electronic Filing and Payment System (EFPS) on April 20, 2006, July 25, 2006 and October 20, 2006, respectively, and its Fourth Quarterly VAT Return on January 25, 2007.[8]

Upon finding some discrepancies between MEDICARD's Income Tax Returns (ITR) and VAT Returns, the CIR informed MEDICARD and issued a Letter Notice (LN) No. 122-VT-06-00-00020 dated September 20, 2007. Subsequently, the CIR also issued a Preliminary Assessment Notice (PAN) against MEDICARD for deficiency VAT. A Memorandum dated December 10, 2007 was likewise issued recommending the issuance of a Formal Assessment Notice (FAN) against MEDICARD.[9]

---

6 **SEC. 249. Interest. -**
x x x x
(C) Delinquency Interest. - In case of failure to pay:
(1) The amount of the tax due on any return to be filed, or
(2) The amount of the tax due for which no return is required, or
(3) A deficiency tax, or any surcharge or interest thereon on the due date appearing in the notice and demand of the Commissioner, there shall be assessed and collected on the unpaid amount, interest at the rate prescribed in Subsection (A) hereof until the amount is fully paid, which interest shall form part of the tax.

7 *Rollo*, p. 190.

8 Id. at 15.

9 Id. at 15-16.

On January 4, 2008, MEDICARD received CIR's FAN dated December 10, 2007 for alleged deficiency VAT for taxable year 2006 in the total amount of ₱196,614,476.69,[10] inclusive of penalties.[11]

According to the CIR, the taxable base of HMOs for VAT purposes is its gross receipts without any deduction under Section 4.108.3(k) of Revenue Regulation (RR) No. 16-2005. Citing *Commissioner of Internal Revenue v. Philippine Health Care Providers, Inc.*,[12] the CIR argued that since MEDICARD does not actually provide medical and/or hospital services, but merely arranges for the same, its services are not VAT exempt.[13]

MEDICARD argued that: (1) the services it render is not limited merely to arranging for the provision of medical and/or hospital services by hospitals and/or clinics but include actual and direct rendition of medical and laboratory services; in fact, its 2006 audited balance sheet shows that it owns x-ray and laboratory facilities which it used in providing medical and laboratory services to its members; (2) out of the ₱1.9 Billion membership fees, ₱319 Million was received from clients that are registered with the Philippine Export Zone Authority (PEZA) and/or Bureau of Investments; (3) the processing fees amounting to ₱11.5 Million should be excluded from

---

10

Receivable from members, beginning		[₱]45,265,483.00
Add/Deduct Adjustments		
1. Membership fees for the year	[₱]1,956,016,629.00	
2. Administrative service fees	3,388,889.00	
3. Professional fees	11,522,346.00	
4. Processing fees	11,008,809.00	
5. Rental income	119,942.00	
6. Unearned fees, ending	405,616,650.00	2,387,673,265.00
		2,432,938,748.00
Less: Receivable from members, ending	85,189,221.00	
Unearned fees, beginning	412,184,856.00	497,374,077.00
Gross receipts subject to VAT		1,935,564,671.00
VAT Rate		12%
Output tax due		207,381,929.04
Less: Input tax		25,794,078.24
VAT payable		181,587,850.80
Less: VAT payments		15,816,053.22
VAT payable		165,771,797.58
Add: Increment		
Surcharge		
Interest (1-26-07 to 12-31-07 or 339 days)	30,792,679.11	
Compromise penalty	50,000.00	30,842,679.11
Total Deficiency VAT Payable		[₱]196,614,476.69

11 *Rollo*, p. 16.

12 550 Phil. 304 (2007).

13 *Rollo*, pp. 16-17.

gross receipts because ₱5.6 Million of which represent advances for professional fees due from clients which were paid by MEDICARD while the remainder was already previously subjected to VAT; (4) the professional fees in the amount of ₱11 Million should also be excluded because it represents the amount of medical services actually and directly rendered by MEDICARD and/or its subsidiary company; and (5) even assuming that it is liable to pay for the VAT, the 12% VAT rate should not be applied on the entire amount but only for the period when the 12% VAT rate was already in effect, *i.e.*, on February 1, 2006. It should not also be held liable for surcharge and deficiency interest because it did not pass on the VAT to its members.[14]

On February 14, 2008, the CIR issued a Tax Verification Notice authorizing Revenue Officer Romualdo Plocios to verify the supporting documents of MEDICARD's Protest. MEDICARD also submitted additional supporting documentary evidence in aid of its Protest thru a letter dated March 18, 2008.[15]

On June 19, 2009, MEDICARD received CIR's Final Decision on Disputed Assessment dated May 15, 2009, denying MEDICARD's protest, to wit:

> **IN VIEW HEREOF**, we deny your letter protest and hereby reiterate in toto assessment of deficiency [VAT] in total sum of P196,614,476.99. It is requested that you pay said deficiency taxes immediately. Should payment be made later, adjustment has to be made to impose interest until date of payment. This is our final decision. If you disagree, you may take an appeal to the [CTA] within the period provided by law, otherwise, said assessment shall become final, executory and demandable.[16]

On July 20, 2009, MEDICARD proceeded to file a petition for review before the CTA, reiterating its position before the tax authorities.[17]

On June 5, 2014, the CTA Division rendered a Decision[18] affirming with modifications the CIR's deficiency VAT assessment covering taxable year 2006, *viz.*:

---

14 Id. at 18-20.
15 Id. at 20.
16 Id.
17 Id.
18 Id. at 124-174.

WHEREFORE, premises considered, the deficiency VAT assessment issued by [CIR] against [MEDICARD] covering taxable year 2006 is hereby **AFFIRMED WITH MODIFICATIONS**. Accordingly, [MEDICARD] is ordered to pay [CIR] the amount of ₱223,173,208.35, inclusive of the twenty-five percent (25%) surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:

Basic Deficiency VAT	₱178,538,566.68
Add: 25% Surcharge	44,634,641.67
Total	**₱223,173,208.35**

In addition, [MEDICARD] is ordered to pay:

a. Deficiency interest at the rate of twenty percent (20%) per annum on the basis deficiency VAT of ₱178,538,566.68 computed from January 25, 2007 until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended; and

b. Delinquency interest at the rate of twenty percent (20%) per annum on the total amount of ₱223,173,208.35 representing basic deficiency VAT of ₱178,538,566.68 and 25% surcharge of ₱44,634,641.67 and on the 20% deficiency interest which have accrued as afore-stated in (a), computed from June 19, 2009 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997.

SO ORDERED.[19]

The CTA Division held that: (1) the determination of deficiency VAT is not limited to the issuance of Letter of Authority (LOA) alone as the CIR is granted vast powers to perform examination and assessment functions; (2) in lieu of an LOA, an LN was issued to MEDICARD informing it of the discrepancies between its ITRs and VAT Returns and this procedure is authorized under Revenue Memorandum Order (RMO) No. 30-2003 and 42-2003; (3) MEDICARD is estopped from questioning the validity of the assessment on the ground of lack of LOA since the assessment issued against MEDICARD contained the requisite legal and factual bases that put MEDICARD on notice of the deficiencies and it in fact availed of the remedies provided by law without questioning the nullity of the assessment; (4) the amounts that MEDICARD earmarked and eventually paid to doctors, hospitals and clinics cannot be excluded from the computation of its gross receipts under the provisions of RR No. 4-2007 because the act of earmarking or allocation is by itself an act of ownership and management over the funds by MEDICARD which is beyond the contemplation of RR No. 4-2007; (5) MEDICARD's earnings from its clinics and laboratory facilities cannot be excluded from its gross receipts because the operation of these clinics and

---

19 Id. at 173.

laboratory is merely an incident to MEDICARD's main line of business as an HMO and there is no evidence that MEDICARD segregated the amounts pertaining to this at the time it received the premium from its members; and (6) MEDICARD was not able to substantiate the amount pertaining to its January 2006 income and therefore has no basis to impose a 10% VAT rate.[20]

Undaunted, MEDICARD filed a Motion for Reconsideration but it was denied. Hence, MEDICARD elevated the matter to the CTA *en banc*.

In a Decision[21] dated September 2, 2015, the CTA *en banc* partially granted the petition only insofar as the 10% VAT rate for January 2006 is concerned but sustained the findings of the CTA Division in all other matters, thus:

> **WHEREFORE**, in view thereof, the instant Petition for Review is hereby **PARTIALLY GRANTED**. Accordingly, the Decision dated June 5, 2014 is hereby **MODIFIED**, as follows:
>
> > "**WHEREFORE**, premises considered, the deficiency VAT assessment issued by [CIR] against [MEDICARD] covering taxable year 2006 is hereby **AFFIRMED WITH MODIFICATIONS**. Accordingly, [MEDICARD] is ordered to pay [CIR] the amount of ₱220,234,609.48, inclusive of the 25% surcharge imposed under Section 248(A)(3) of the NIRC of 1997, as amended, computed as follows:
>
> | | |
> |---|---|
> | Basic Deficiency VAT | ₱176,187,687.58 |
> | Add: 25% Surcharge | 44,046,921.90 |
> | **Total** | **₱220,234,609.48** |
>
> In addition, [MEDICARD] is ordered to pay:
>
> (a) Deficiency interest at the rate of 20% per annum on the basic deficiency VAT of ₱176,187,687.58 computed from January 25, 2007 until full payment thereof pursuant to Section 249(B) of the NIRC of 1997, as amended; and
>
> (b) Delinquency interest at the rate of 20% per annum on the total amount of ₱220,234,609.48 (representing basic deficiency VAT of ₱176,187,687.58 and 25% surcharge of ₱44,046,921.90) and on the deficiency interest which have accrued as afore-stated in (a), computed from June 19, 2009 until full payment thereof pursuant to Section 249(C) of the NIRC of 1997, as amended."

---

20 Id. at 153-170.

21 Id. at 13-45.

SO ORDERED.[22]

Disagreeing with the CTA *en banc*'s decision, MEDICARD filed a motion for reconsideration but it was denied.[23] Hence, MEDICARD now seeks recourse to this Court *via* a petition for review on *certiorari*.

The Issues

1. WHETHER THE ABSENCE OF THE LOA IS FATAL; and

2. WHETHER THE AMOUNTS THAT MEDICARD EARMARKED AND EVENTUALLY PAID TO THE MEDICAL SERVICE PROVIDERS SHOULD STILL FORM PART OF ITS GROSS RECEIPTS FOR VAT PURPOSES.[24]

Ruling of the Court

The petition is meritorious.

The absence of an LOA violated MEDICARD's right to due process

An LOA is the authority given to the appropriate revenue officer assigned to perform assessment functions. It empowers or enables said revenue officer to examine the books of account and other accounting records of a taxpayer for the purpose of collecting the correct amount of tax.[25] An LOA is premised on the fact that the examination of a taxpayer who has already filed his tax returns is a power that statutorily belongs only to the CIR himself or his duly authorized representatives. Section 6 of the NIRC clearly provides as follows:

> **SEC. 6.** *Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement.* –
>
> (A) **Examination of Return and Determination of Tax Due.** – After a return has been filed as required under the provisions of this Code, **the Commissioner or his duly authorized representative may**

22 Id. at 43-44.
23 Id. at 46-59.
24 Id. at 197-198.
25 *Commissioner of Internal Revenue v. Sony Philippines, Inc.*, 649 Phil. 519, 529-530 (2010).

> **authorize the examination of any taxpayer** and the assessment of the correct amount of tax: Provided, however, That failure to file a return shall not prevent the Commissioner from authorizing the examination of any taxpayer.
>
> x x x x (Emphasis and underlining ours)

Based on the afore-quoted provision, it is clear that unless authorized by the CIR himself or by his duly authorized representative, through an LOA, an examination of the taxpayer cannot ordinarily be undertaken. The circumstances contemplated under Section 6 where the taxpayer may be assessed through best-evidence obtainable, inventory-taking, or surveillance among others has nothing to do with the LOA. These are simply methods of examining the taxpayer in order to arrive at the correct amount of taxes. Hence, unless undertaken by the CIR himself or his duly authorized representatives, other tax agents may not validly conduct any of these kinds of examinations without prior authority.

With the advances in information and communication technology, the Bureau of Internal Revenue (BIR) promulgated RMO No. 30-2003 to lay down the policies and guidelines once its then incipient centralized Data Warehouse (DW) becomes fully operational in conjunction with its Reconciliation of Listing for Enforcement System (RELIEF System).[26] This system can detect tax leaks by matching the data available under the BIR's Integrated Tax System (ITS) with data gathered from third-party sources. Through the consolidation and cross-referencing of third-party information, discrepancy reports on sales and purchases can be generated to uncover under declared income and over claimed purchases of goods and services.

Under this RMO, several offices of the BIR are tasked with specific functions relative to the RELIEF System, particularly with regard to LNs. Thus, the Systems Operations Division (SOD) under the Information Systems Group (ISG) is responsible for: (1) coming up with the List of Taxpayers with discrepancies within the threshold amount set by management for the issuance of LN and for the system-generated LNs; and (2) sending the same to the taxpayer and

---

[26] The following are the objectives of RMO No. 30-2003: 1. Establish adequate controls to ensure security/integrity and confidentiality of RELIEF data maintained in the DW, consistent with relevant statutes and policies concerning Unlawful Disclosure; 2. Delineate the duties and responsibilities of offices responsible for oversight of the RELIEF system including all activities associated with requests for access and farming out of RELIEF data to the regional and district offices; 3. Prescribe procedures in the resolution of matched error or discrepancies, examination of taxpayer's records, assessment and collection of deficiency taxes; and 4. Prescribe standard report format to be used by all concerned offices in the implementation of this Order. <https://www.bir.gov.ph/images/bir_files/old_files/pdf/1966rmo03_30.pdf> visited last March 7, 2017.

to the Audit Information, Tax Exemption and Incentives Division (AITEID). After receiving the LNs, the AITEID under the Assessment Service (AS), in coordination with the concerned offices under the ISG, shall be responsible for transmitting the LNs to the investigating offices [Revenue District Office (RDO)/Large Taxpayers District Office (LTDO)/Large Taxpayers Audit and Investigation Division (LTAID)]. At the level of these investigating offices, the appropriate action on the LNs issued to taxpayers with RELIEF data discrepancy would be determined.

RMO No. 30-2003 was supplemented by RMO No. 42-2003, which laid down the "***no-contact-audit approach***" in the CIR's exercise of its power to authorize any examination of taxpayer and the assessment of the correct amount of tax. The *no-contact-audit approach* includes the process of computerized matching of sales and purchases data contained in the Schedules of Sales and Domestic Purchases, and Schedule of Importation submitted by VAT taxpayers under the RELIEF System pursuant to RR No. 7-95, as amended by RR Nos. 13-97, 7-99 and 8-2002. This may also include the matching of data from other information or returns filed by the taxpayers with the BIR such as Alphalist of Payees subject to Final or Creditable Withholding Taxes.

Under this policy, even without conducting a detailed examination of taxpayer's books and records, if the computerized/manual matching of sales and purchases/expenses appears to reveal discrepancies, the same shall be communicated to the concerned taxpayer through the issuance of LN. The LN shall serve as a discrepancy notice to taxpayer similar to a Notice for Informal Conference to the concerned taxpayer. Thus, under the RELIEF System, a revenue officer may begin an examination of the taxpayer even prior to the issuance of an LN or even in the absence of an LOA with the aid of a computerized/manual matching of taxpayers' documents/records. Accordingly, under the RELIEF System, the presumption that the tax returns are in accordance with law and are presumed correct since these are filed under the penalty of perjury[27] are easily rebutted and the taxpayer becomes instantly burdened to explain a purported discrepancy.

Noticeably, both RMO No. 30-2003 and RMO No. 42-2003 are silent on the statutory requirement of an LOA before any investigation or examination of the taxpayer may be conducted. As provided in the RMO No. 42-2003, the LN is merely similar to a Notice for Informal

---

[27] *SMI-Ed Philippines Technology, Inc. v. Commissioner of Internal Revenue*, G.R. No. 175410, November 12, 2014, 739 SCRA 691, 701.

Conference. However, for a Notice of Informal Conference, which generally precedes the issuance of an assessment notice to be valid, the same presupposes that the revenue officer who issued the same is properly authorized in the first place.

With this apparent lacuna in the RMOs, in November 2005, RMO No. 30-2003, as supplemented by RMO No. 42-2003, was amended by RMO No. 32-2005 to fine tune existing procedures in handing assessments against taxpayers'' issued LNs by reconciling various revenue issuances which conflict with the NIRC. Among the objectives in the issuance of RMO No. 32-2005 is to prescribe procedure in the resolution of LN discrepancies, conversion of LNs to LOAs and assessment and collection of deficiency taxes.

IV. POLICIES AND GUIDELINES

x x x x

8. In the event a taxpayer who has been issued an LN refutes the discrepancy shown in the LN, the concerned taxpayer will be given an opportunity to reconcile its records with those of the BIR within One Hundred and Twenty (120) days from the date of the issuance of the LN. However, the subject taxpayer shall no longer be entitled to the abatement of interest and penalties after the lapse of the sixty (60)-day period from the LN issuance.

9. In case the above discrepancies remained unresolved at the end of the One Hundred and Twenty (120)-day period, the revenue officer (RO) assigned to handle the LN shall recommend the issuance of [LOA] to replace the LN. The head of the concerned investigating office shall submit a summary list of LNs for conversion to LAs (using the herein prescribed format in Annex "E" hereof) to the OACIR-LTS / ORD for the preparation of the corresponding LAs with the notation "This LA cancels LN No._____."

x x x x

V. PROCEDURES

x x x x

B. At the Regional Office/Large Taxpayers Service

x x x x

7. Evaluate the Summary List of LNs for Conversion to LAs submitted by the RDO x x x prior to approval.

8. Upon approval of the above list, prepare/accomplish and sign the corresponding LAs.

> x x x x
>
> 10. Transmit the approved/signed LAs, together with the duly accomplished/approved Summary List of LNs for conversion to LAs, to the concerned investigating offices for the encoding of the required information x x x and for service to the concerned taxpayers.
>
> x x x x
>
> C. At the RDO x x x
>
> x x x x
>
> 11. If the LN discrepancies remained unresolved within One Hundred and Twenty (120) days from issuance thereof, prepare a summary list of said LNs for conversion to LAs x x x.
>
> x x x x
>
> 16. **Effect the service of the above LAs to the concerned taxpayers.**[28]

In this case, there is no dispute that no LOA was issued prior to the issuance of a PAN and FAN against MEDICARD. Therefore no LOA was also served on MEDICARD. The LN that was issued earlier was also not converted into an LOA contrary to the above quoted provision. Surprisingly, the CIR did not even dispute the applicability of the above provision of RMO 32-2005 in the present case which is clear and unequivocal on the necessity of an LOA for the assessment proceeding to be valid. Hence, the CTA's disregard of MEDICARD's right to due process warrant the reversal of the assailed decision and resolution.

In the case of *Commissioner of Internal Revenue v. Sony Philippines, Inc.*,[29] the Court said that:

> Clearly, there must be a grant of authority before any revenue officer can conduct an examination or assessment. Equally important is that the revenue officer so authorized must not go beyond the authority given. **In the absence of such an authority, the assessment or examination is a nullity**.[30] (Emphasis and underlining ours)

The Court cannot convert the LN into the LOA required under the law even if the same was issued by the CIR himself. Under RR No. 12-2002, LN is issued to a person found to have underreported sales/receipts per data

---

28 <https://www.bir.gov.ph/images/bir_filed/old_files/pdf/27350RMO%2032-2005.pdf> visited last March 7, 2017.

29 649 Phil. 519 (2010).

30 Id. at 530.

generated under the RELIEF system. Upon receipt of the LN, a taxpayer may avail of the BIR's Voluntary Assessment and Abatement Program. If a taxpayer fails or refuses to avail of the said program, the BIR may avail of administrative and criminal remedies, particularly closure, criminal action, or audit and investigation. Since the law specifically requires an LOA and RMO No. 32-2005 requires the conversion of the previously issued LN to an LOA, the absence thereof cannot be simply swept under the rug, as the CIR would have it. In fact Revenue Memorandum Circular No. 40-2003 considers an LN as a notice of audit or investigation only for the purpose of disqualifying the taxpayer from amending his returns.

The following differences between an LOA and LN are crucial. First, an LOA addressed to a revenue officer is specifically required under the NIRC before an examination of a taxpayer may be had while an LN is not found in the NIRC and is only for the purpose of notifying the taxpayer that a discrepancy is found based on the BIR's RELIEF System. Second, an LOA is valid only for 30 days from date of issue while an LN has no such limitation. Third, an LOA gives the revenue officer only a period of 120 days from receipt of LOA to conduct his examination of the taxpayer whereas an LN does not contain such a limitation.[31] Simply put, LN is entirely different and serves a different purpose than an LOA. Due process demands, as recognized under RMO No. 32-2005, that after an LN has serve its purpose, the revenue officer should have properly secured an LOA before proceeding with the further examination and assessment of the petitioner. Unfortunately, this was not done in this case.

Contrary to the ruling of the CTA *en banc*, an LOA cannot be dispensed with just because none of the financial books or records being physically kept by MEDICARD was examined. To begin with, Section 6 of the NIRC requires an authority from the CIR or from his duly authorized representatives before an examination "of a taxpayer" may be made. The requirement of authorization is therefore not dependent on whether the taxpayer may be required to physically open his books and financial records but only on whether a taxpayer is being subject to examination.

The BIR's RELIEF System has admittedly made the BIR's assessment and collection efforts much easier and faster. The ease by which the BIR's revenue generating objectives is achieved is no excuse however for its non-compliance with the statutory requirement under Section 6 and with its own administrative issuance. In fact, apart from being a statutory requirement, an LOA is equally needed even under the BIR's RELIEF System because the rationale of requirement is the same whether or not the CIR conducts a physical examination of the taxpayer's records: to prevent undue harassment of a taxpayer and level the playing field between

---

31 BIR's General Audit Procedures and Documentation

the government's vast resources for tax assessment, collection and enforcement, on one hand, and the solitary taxpayer's dual need to prosecute its business while at the same time responding to the BIR exercise of its statutory powers. The balance between these is achieved by ensuring that any examination of the taxpayer by the BIR's revenue officers is properly authorized in the first place by those to whom the discretion to exercise the power of examination is given by the statute.

That the BIR officials herein were not shown to have acted unreasonably is beside the point because the issue of their lack of authority was only brought up during the trial of the case. What is crucial is whether the proceedings that led to the issuance of VAT deficiency assessment against MEDICARD had the prior approval and authorization from the CIR or her duly authorized representatives. Not having authority to examine MEDICARD in the first place, the assessment issued by the CIR is inescapably void.

At any rate, even if it is assumed that the absence of an LOA is not fatal, the Court still partially finds merit in MEDICARD's substantive arguments.

The amounts earmarked and eventually paid by MEDICARD to the medical service providers do not form part of gross receipts for VAT purposes

MEDICARD argues that the CTA *en banc* seriously erred in affirming the ruling of the CTA Division that the gross receipts of an HMO for VAT purposes shall be the total amount of money or its equivalent actually received from members undiminished by any amount paid or payable to the owners/operators of hospitals, clinics and medical and dental practitioners. MEDICARD explains that its business as an HMO involves two different although interrelated contracts. One is between a corporate client and MEDICARD, with the corporate client's employees being considered as MEDICARD members; and the other is between the healthcare institutions/healthcare professionals and MEDICARD.

Under the first, MEDICARD undertakes to make arrangements with healthcare institutions/healthcare professionals for the coverage of MEDICARD members under specific health related services for a specified period of time in exchange for payment of a more or less fixed membership fee. Under its contract with its corporate clients, MEDICARD expressly provides that 20% of the membership fees per

individual, regardless of the amount involved, already includes the VAT of 10%/20% excluding the remaining 80% because MEDICARD would earmark this latter portion for medical utilization of its members. Lastly, MEDICARD also assails CIR's inclusion in its gross receipts of its earnings from medical services which it actually and directly rendered to its members.

Since an HMO like MEDICARD is primarily engaged in arranging for coverage or designated managed care services that are needed by plan holders/members for fixed prepaid membership fees and for a specified period of time, then MEDICARD is principally engaged in the sale of services. Its VAT base and corresponding liability is, thus, determined under Section 108(A)[32] of the Tax Code, as amended by Republic Act No. 9337.

---

32 SEC. 108. *Value-added Tax on Sale of Services and Use or Lease of Properties.* -

(A) *Rate and Base of Tax.* - There shall be levied, assessed and collected, a value-added tax equivalent to ten percent (12%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties: Provided, That the President, upon the recommendation of the Secretary of Finance, shall, effective January 1, 2006, raise the rate of value-added tax to twelve percent (12%), after any of the following conditions has been satisfied:

(i) Value-added tax collection as a percentage of Gross Domestic Product (GDP) of the previous year exceeds two and four-fifth percent (2 4/5%); or

(ii) National government deficit as a percentage of GDP of the previous year exceeds one and one-half percent (1 1/2%).

The phrase '**sale or exchange of services**' means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration, including those performed or rendered by construction and service contractors; stock, real estate, commercial, customs and immigration brokers; lessors of property, whether personal or real; warehousing services; lessors or distributors of cinematographic films; persons engaged in milling, processing, manufacturing or repacking goods for others; proprietors, operators or keepers of hotels, motels, rest-houses, pension houses, inns, resorts; proprietors or operators of restaurants, refreshment parlors, cafes and other eating places, including clubs and caterers; dealers in securities; lending investors; transportation contractors on their transport of goods or cargoes, including persons who transport goods or cargoes for hire and other domestic common carriers by land relative to their transport of goods or cargoes; common carriers by air and sea relative to their transport of passengers, goods or cargoes from one place in the Philippines to another place in the Philippines; sales of electricity by generation companies, transmission, and distribution companies; services of franchise grantees of electric utilities, telephone and telegraph, radio and television broadcasting and all other franchise grantees except those under Section 119 of this Code and non-life insurance companies (except their crop insurances), including surety, fidelity, indemnity and bonding companies; and similar services regardless of whether or not the performance thereof calls for the exercise or use of the physical or mental faculties. The phrase '**sale or exchange of services**' shall likewise include:

(1) The lease or the use of or the right or privilege to use any copyright, patent, design or model plan, secret formula or process, goodwill, trademark, trade brand or other like property or right;

(2) The lease or the use of, or the right to use of any industrial, commercial or, scientific equipment;

(3) The supply of scientific, technical, industrial or commercial knowledge or information;

(4) The supply of any assistance that is ancillary and subsidiary to and is furnished as a means of enabling the application or enjoyment of any such property, or right as is mentioned in subparagraph (2) or any such knowledge or information as is mentioned in subparagraph (3);

(5) The supply of services by a nonresident person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any brand, machinery or other apparatus purchased from such nonresident person;

Prior to RR No. 16-2005, an HMO, like a pre-need company, is treated for VAT purposes as a dealer in securities whose gross receipts is the amount actually received as contract price without allowing any deduction from the gross receipts.[33] This restrictive tenor changed under RR No. 16-2005. Under this RR, an HMO's gross receipts and gross receipts in general were defined, thus:

> **Section 4.108-3.** x x x
>
> x x x x
>
> HMO's gross receipts shall be the total amount of money or its equivalent representing the service fee actually or constructively received during the taxable period for the services performed or to be performed for another person, excluding the value-added tax. **The compensation for their services representing their service fee, is presumed to be the total amount received as enrollment fee from their members plus other charges received.**
>
> **Section 4.108-4.** x x x. "***Gross receipts***" refers to the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits applied as **payments for services rendered**, and advance payments actually or constructively received during the taxable period **for the services performed or to be performed** for another person, excluding the VAT.[34]

---

(6) The supply of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;

(7) The lease of motion picture films, films, tapes and discs; and

(8) The lease or the use of or the right to use radio, television, satellite transmission and cable television time.

Lease of properties shall be subject to the tax herein imposed irrespective of the place where the contract of lease or licensing agreement was executed if the property is leased or used in the Philippines.

The term 'gross receipts' means the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits and advanced payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person, excluding value-added tax. (Emphasis ours)

33 RR No. 14-2005, Section 4.108-3 (i).

34 <https://www.bir.gov.ph/images/bir_files/old_files/pdf/26116rr16-2005.pdf> visited last March 7, 2017.

In 2007, the BIR issued RR No. 4-2007 amending portions of RR No. 16-2005, including the definition of gross receipts in general.[35]

According to the CTA *en banc*, the entire amount of membership fees should form part of MEDICARD's gross receipts because the exclusions to the gross receipts under RR No. 4-2007 does not apply to MEDICARD. What applies to MEDICARD is the definition of gross receipts of an HMO under RR No. 16-2005 and not the modified definition of gross receipts in general under the RR No. 4-2007.

The CTA *en banc* overlooked that the definition of gross receipts under RR No. 16-2005 merely presumed that the amount received by an HMO as membership fee is the HMO's compensation for their services. As a mere presumption, an HMO is, thus, allowed to establish that a portion of the amount it received as membership fee does NOT actually compensate it but some other person, which in this case are the medical service providers themselves. It is a well-settled principle of legal hermeneutics that words of a statute will be interpreted in their natural, plain and ordinary acceptation and signification, unless it is evident that the legislature intended a technical or special legal meaning to those words. The Court cannot read the word "presumed" in any other way.

It is notable in this regard that the term gross receipts as elsewhere mentioned as the tax base under the NIRC does not contain any specific definition.[36] Therefore, absent a statutory definition, this Court has construed the term gross receipts in its plain and ordinary meaning, that is, gross receipts is understood as comprising the entire receipts without any deduction.[37] Congress, under Section 108, could have simply left the term

---

[35] Gross receipts' refers to the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits applied as payments for services rendered and advance payments actually or constructively received during the taxable period for the services performed or to be performed for another person, excluding the VAT, except those amounts earmarked for payment to unrelated third (3rd) party or received as reimbursement for advance payment on behalf of another which do not redound to the benefit of the payor.

A payment is a payment to a third (3rd) party if the same is made to settle an obligation of another person, e.g., customer or client, to the said third party, which obligation is evidenced by the sales invoice/official receipt issued by said third party to the obligor/debtor (e.g., customer or client of the payor of the obligation).

An advance payment is an advance payment on behalf of another if the same is paid to a third (3rd) party for a present or future obligation of said another party which obligation is evidenced by a sales invoice/official receipt issued by the obligee/creditor to the obligor/debtor (i.e., the aforementioned 'another party') for the sale of goods or services by the former to the latter.

For this purpose 'unrelated party' shall not include taxpayer's employees, partners, affiliates (parent, subsidiary and other related companies), relatives by consanguinity or affinity within the fourth (4th) civil degree, and trust fund where the taxpayer is the trustor, trustee or beneficiary, even if covered by an agreement to the contrary. (Underlining in the original)

[36] Compare with Section 125 of the NIRC, where the gross receipts for purposes of amusement tax broadly included "all receipts of the proprietor, lessee or operator of the amusement place." *See* Sections 116, 117, 119 and 121 of the NIRC, as amended by R.A. No. 9337.

[37] *Commissioner of Internal Revenue v. Bank of Commerce*, 498 Phil. 673, 685 (2005).

gross receipts similarly undefined and its interpretation subjected to ordinary acceptation. Instead of doing so, Congress limited the scope of the term gross receipts for VAT purposes only to the amount that the taxpayer received for the services it performed or to the amount it received as advance payment for the services it will render in the future for another person.

In the proceedings below, the nature of MEDICARD's business and the extent of the services it rendered are not seriously disputed. As an HMO, MEDICARD primarily acts as an intermediary between the purchaser of healthcare services (its members) and the healthcare providers (the doctors, hospitals and clinics) for a fee. By enrolling membership with MEDICARD, its members will be able to avail of the pre-arranged medical services from its accredited healthcare providers without the necessary protocol of posting cash bonds or deposits prior to being attended to or admitted to hospitals or clinics, especially during emergencies, at any given time. Apart from this, MEDICARD may also directly provide medical, hospital and laboratory services, which depends upon its member's choice.

Thus, in the course of its business as such, MEDICARD members can either avail of medical services from MEDICARD's accredited healthcare providers or directly from MEDICARD. In the former, MEDICARD members obviously knew that beyond the agreement to pre-arrange the healthcare needs of its members, MEDICARD would not actually be providing the actual healthcare service. Thus, based on industry practice, MEDICARD informs its would-be member beforehand that 80% of the amount would be earmarked for medical utilization and only the remaining 20% comprises its service fee. In the latter case, MEDICARD's sale of its services is exempt from VAT under Section 109(G).

The CTA's ruling and CIR's Comment have not pointed to any portion of Section 108 of the NIRC that would extend the definition of gross receipts even to amounts that do not only pertain to the services to be performed by another person, other than the taxpayer, but even to amounts that were indisputably utilized not by MEDICARD itself but by the medical service providers.

It is a cardinal rule in statutory construction that no word, clause, sentence, provision or part of a statute shall be considered surplusage or superfluous, meaningless, void and insignificant. To this end, a construction which renders every word operative is preferred over that which makes some words idle and nugatory. This principle is expressed in the maxim *Ut magis valeat quam pereat*, that is, we choose the interpretation which gives effect to the whole of the statute – its every word.

In *Philippine Health Care Providers, Inc. v. Commissioner of Internal Revenue*,[38] the Court adopted the principal object and purpose object in determining whether the MEDICARD therein is engaged in the business of insurance and therefore liable for documentary stamp tax. The Court held therein that an HMO engaged in preventive, diagnostic and curative medical services is not engaged in the business of an insurance, thus:

> To summarize, the distinctive features of the cooperative are **the rendering of service, its extension, the bringing of physician and patient together, the preventive features, the regularization of service as well as payment, the substantial reduction in cost by quantity purchasing in short, getting the medical job done and paid for; not, except incidentally to these features, the indemnification for cost after the services is rendered. Except the last, these are not distinctive or generally characteristic of the insurance arrangement.** There is, therefore, a substantial difference between contracting in this way for the rendering of service, even on the contingency that it be needed, and contracting merely to stand its cost when or after it is rendered.[39] (Emphasis ours)

In sum, the Court said that the main difference between an HMO and an insurance company is that HMOs undertake to provide or arrange for the provision of medical services through participating physicians while insurance companies simply undertake to indemnify the insured for medical expenses incurred up to a pre-agreed limit. In the present case, the VAT is a tax on the value added by the performance of the service by the taxpayer. It is, thus, this service and the value charged thereof by the taxpayer that is taxable under the NIRC.

To be sure, there are pros and cons in subjecting the entire amount of membership fees to VAT.[40] But the Court's task however is not to weigh these policy considerations but to determine if these considerations in favor of taxation can even be implied from the statute where the CIR purports to derive her authority. This Court rules that they cannot because the language of the NIRC is pretty straightforward and clear. As this Court previously ruled:

---

[38] 616 Phil. 387 (2009).

[39] Id. at 404-405, citing *Jordan v. Group Health Association*, 107 F.2d 239, 247-248 (D.C. App. 1939).

[40] For instance, arguably, excluding from an HMO's gross receipts the amount that they indisputably utilized for the benefit of their members could mean lessening the state's burden of having to spend for the amount of these services were it not for the favorable effect of the exclusion on the overall healthcare scheme. Similarly, the indirect benefits of an HMO's diagnostic and preventive medical health service (as distinguished from its curative medical health service generally associated with the reimbursement scheme of health insurance) to the state's legitimate interest of maintaining a healthy population may also arguably explain the exclusion of the medically utilized amount from an HMO's gross receipts.

> What is controlling in this case is the well-settled doctrine of strict interpretation in the imposition of taxes, not the similar doctrine as applied to tax exemptions. The rule in the interpretation of tax laws is that a statute will not be construed as imposing a tax unless it does so clearly, expressly, and unambiguously. **A tax cannot be imposed without clear and express words for that purpose. Accordingly, the general rule of requiring adherence to the letter in construing statutes applies with peculiar strictness to tax laws and the provisions of a taxing act are not to be extended by implication**. In answering the question of who is subject to tax statutes, it is basic that in case of doubt, such statutes are to be construed most strongly against the government and in favor of the subjects or citizens because burdens are not to be imposed nor presumed to be imposed beyond what statutes expressly and clearly import. As burdens, taxes should not be unduly exacted nor assumed beyond the plain meaning of the tax laws.[41] (Citation omitted and emphasis and underlining ours)

For this Court to subject the entire amount of MEDICARD's gross receipts without exclusion, the authority should have been reasonably founded from the language of the statute. That language is wanting in this case. In the scheme of judicial tax administration, the need for certainty and predictability in the implementation of tax laws is crucial. Our tax authorities fill in the details that Congress may not have the opportunity or competence to provide. The regulations these authorities issue are relied upon by taxpayers, who are certain that these will be followed by the courts. Courts, however, will not uphold these authorities' interpretations when clearly absurd, erroneous or improper.[42] The CIR's interpretation of gross receipts in the present case is patently erroneous for lack of both textual and non-textual support.

As to the CIR's argument that the act of earmarking or allocation is by itself an act of ownership and management over the funds, the Court does not agree. On the contrary, it is MEDICARD's act of earmarking or allocating 80% of the amount it received as membership fee at the time of payment that weakens the ownership imputed to it. By earmarking or allocating 80% of the amount, MEDICARD unequivocally recognizes that its possession of the funds is not in the concept of owner but as a mere administrator of the same. For this reason, at most, MEDICARD's right in relation to these amounts is a mere inchoate owner which would ripen into actual ownership if, and only if, there is underutilization of the membership fees at the end of the fiscal year. Prior to that, MEDICARD is bound to pay from the amounts it had allocated as an administrator once its members avail of the medical services of MEDICARD's healthcare providers.

---

41 *Commissioner of Internal Revenue v. Fortune Tobacco Corporation*, 581 Phil. 146, 168 (2008).

42 *Commissioner of Internal Revenue v. Central Luzon Drug Corporation*, 496 Phil. 307, 332 (2005).

Before the Court, the parties were one in submitting the legal issue of whether the amounts MEDICARD earmarked, corresponding to 80% of its enrollment fees, and paid to the medical service providers should form part of its gross receipt for VAT purposes, after having paid the VAT on the amount comprising the 20%. It is significant to note in this regard that MEDICARD established that upon receipt of payment of membership fee it actually issued two official receipts, one pertaining to the VATable portion, representing compensation for its services, and the other represents the non-vatable portion pertaining to the amount earmarked for medical utilization. Therefore, the absence of an actual and physical segregation of the amounts pertaining to two different kinds of fees cannot arbitrarily disqualify MEDICARD from rebutting the presumption under the law and from proving that indeed services were rendered by its healthcare providers for which it paid the amount it sought to be excluded from its gross receipts.

With the foregoing discussions on the nullity of the assessment on due process grounds and violation of the NIRC, on one hand, and the utter lack of legal basis of the CIR's position on the computation of MEDICARD's gross receipts, the Court finds it unnecessary, nay useless, to discuss the rest of the parties' arguments and counter-arguments.

In fine, the foregoing discussion suffices for the reversal of the assailed decision and resolution of the CTA *en banc* grounded as it is on due process violation. The Court likewise rules that for purposes of determining the VAT liability of an HMO, the amounts earmarked and actually spent for medical utilization of its members should not be included in the computation of its gross receipts.

WHEREFORE, in consideration of the foregoing disquisitions, the petition is hereby **GRANTED**. The Decision dated September 2, 2015 and Resolution dated January 29, 2016 issued by the Court of Tax Appeals *en banc* in CTA EB No. 1224 are **REVERSED** and **SET ASIDE**. The definition of gross receipts under Revenue Regulations Nos. 16-2005 and 4-2007, in relation to Section 108(A) of the National Internal Revenue Code, as amended by Republic Act No. 9337, for purposes of determining its Value-Added Tax liability, is hereby declared to **EXCLUDE** the eighty percent (80%) of the amount of the contract price earmarked as fiduciary funds for the medical utilization of its members. Further, the Value-Added Tax deficiency assessment issued against Medicard Philippines, Inc. is hereby declared unauthorized for having been issued without a Letter of Authority by the Commissioner of Internal Revenue or his duly authorized representatives.

SO ORDERED.

BIENVENIDO L. REYES
Associate Justice

WE CONCUR:

PRESBITERO J. VELASCO, JR.
Associate Justice
Chairperson

LUCAS P. BERSAMIN
Associate Justice

ALFREDO BENJAMIN S. CAGUIOA
Associate Justice

NOEL G. TIJAM
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

PRESBITERO J. VELASCO, JR.
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution and the Division Chairperson's Attestation, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

MARIA LOURDES P. A. SERENO
Chief Justice

CERTIFIED TRUE COPY
WILFREDO V. LAPITAN
Division Clerk of Court
Third Division
MAY 03 2017