



Republic of the Philippines
DEPARTMENT OF FINANCE

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Manila 1004

DOF Opinion No. 017.2022

MR. ANTHONY P. NAZARIO

Executive Vice President

Knights of Columbus Fraternal Association of the Philippines, Inc.

Gen. Luna corner Sta. Potenciana Streets, Intramuros, Manila

**SUBJECT: Request for Review of Bureau of Internal Revenue
Ruling No. S30(C)-502-2020 dated 8 September 2020**

Dear Mr. Nazario:

This refers to the request for review filed by **KNIGHTS OF COLUMBUS FRATERNAL ASSOCIATION OF THE PHILIPPINES, INC. (KCFAPI)** on 20 June 2022 of Bureau of Internal Revenue (BIR) Ruling No. S30(C)-502-2020 dated 8 September 2020, which denied KCFAPI's request for tax exemption as a non-stock, non-profit corporation or association under Section 30(C) of the National Internal Revenue Code (NIRC), as amended.¹

As stated in its submitted Amended Articles of Incorporation dated 9 September 2014, KCFAPI is organized as a non-stock, non-profit **mutual benefit association** under the laws of the Republic of the Philippines. The purposes for which KCFAPI was incorporated are as follows:

- a. To render mutual aid and assistance to members and their immediate families and their beneficiaries for losses and damages arising from injuries and/or losses of lives and properties.
- b. To render mutual aid assistance to sick, disabled and needy members and/or immediate members of the families.
- c. To engage in public and private relief works and to provide for the economic, social, religious and educational requirements and needs of the members and their families.

¹ The NIRC, as amended, is also referred to in this Opinion as the "Tax Code".

- d. In general, do such acts and things and to undertake such activities not otherwise prohibited by law which are calculated to help the members and their families in particular and the country in general or which may be necessary directly or indirectly for the accomplishment of the purposes for which the corporation has been formed or organized.

KCFAPI requested from the BIR confirmation of income tax exemption pursuant to Section 30(C) of the NIRC, as amended, which reads:

SEC. 30. Exemptions from Tax on Corporations. - The following organizations shall not be taxed under this Title in respect to income received by them as such:

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(C) A beneficiary society, order or association, operating for the exclusive benefit of the members such as a fraternal organization operating under the lodge system, or mutual aid association or a nonstock corporation organized by employees providing for the payment of life, sickness, accident, or other benefits exclusively to the members of such society, order, or association, or nonstock corporation or their dependents;

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However, in BIR Ruling No. S30(C)-502-2020 dated 8 September 2020, the BIR denied KCFAPI's request for tax exemption as a non-stock, non-profit corporation or association, stating that:

"In the submitted documents of [KCFAPI], it is shown that it receives and manages funds associated with savings or investment programs. xxx

"Additionally, By-Laws of [KCFAPI] disclosed that Board of Trustees is allowed to declare dividends from surplus. Section 1 of Article XIV of the By-Law of [KCFAPI] states that:

"Section 1. The Board of Trustees shall, from time to time, upon a majority vote, declare dividends from surplus, if in their judgement and upon the advice of

the Actuary it is deemed advisable to do. Payments shall be made by reduction of the assessments or contributions of the members in any one year or by any other method subject to the discretion of the Board of Trustees.”

“It is clear in Revenue Memorandum Circular (RMC) No. 51-2014,² that **receiving and managing funds associated with savings or investment programs is a form of inurement and is not allowed in a society, order, association or non-stock corporation** under Section 30 (C) of the NIRC providing for the payment of life, sickness, accident and other benefits exclusively to its members or their dependents. Moreover, **the declaration of dividends from surplus is considered a distribution of the equity** (including the net income) of [KCFAPI]. **These are forms of private inurement which the law prohibits in the organization and operation of a non-stock, non-profit corporation.** These acts violate the requirement that no part of the net income or assets of the corporation shall inure to the benefit of any individual or specific person. Thus, [KCFAPI] cannot be qualified as a non-stock, non-profit corporation under Section 30 (C) of the National Internal Revenue Code of 1997, as amended.”³

The dispositive portion of the BIR ruling reads:

“In view of the foregoing, the request of [KCFAPI] to be exempted from income tax on its income as a Section (30) (C) corporation is hereby denied as it failed to prove that it is a non-stock, non-profit corporation. Therefore, [KCFAPI] shall be treated as an ordinary corporation subject to thirty percent (30%) income tax rate pursuant to Section 27 (A) and other internal revenue taxes imposed by the National Internal Revenue Code of 1997, as amended.”

² Subject: Clarifying the Inurement Prohibition under Section 30 of the National Internal Revenue Code of 1997

³ Emphasis supplied.

On 20 May 2022, KCFAPI received the subject Ruling and filed the instant Request for Review on 20 June 2022, well within the period prescribed under Section 3 of DOF Department Order No. 7-02.⁴

KCFAPI is duly organized as a mutual benefit association

As provided under KCFAPI's Amended Articles of Incorporation, KCFAPI has been organized as a non-stock, non-profit **"mutual benefit association"**. Section 403 of Republic Act No. 10607,⁵ otherwise known as "The Insurance Code," defines mutual benefit association as follows:

"Section 403. Any society, association or corporation, without capital stock, formed or organized not for profit but mainly for the purpose of paying sick benefits to members, or of furnishing financial support to members while out of employment, or of paying to relatives of deceased members of fixed or any sum of money, irrespective of whether such aim or purpose is carried out by means of fixed dues or assessments collected regularly from the members, or of providing, by the issuance of certificates of insurance, payment of its members of accident or life insurance benefits out of such fixed and regular dues or assessments, but in no case shall include any society, association, or corporation with such mutual benefit features and which shall be carried out purely from voluntary contributions collected not regularly and/or no fixed amount from whomsoever may contribute, shall be known as a mutual benefit association within the intent of this Code.⁶

⁴ Department Order No. 7-02. Providing for the Implementing Rules of the First Paragraph of Section 4 of the National Internal Revenue Code of 1997, Repealing for this Purpose Department Order No. 005-99 and Revenue Administrative Order No. 01-99. Section 3 of DOF Department Order (DO) No. 007-02 provides that a taxpayer who receives an adverse ruling from the CIR may seek its review by the Secretary of Finance by filing a sworn request for review within 30 days from the date of receipt of said ruling.

The subject ruling was received by KCFAPI on 20 May 2022, by which it had until 19 June 2022 to file a Request for Review. The last day, 19 June 2022, being a non-working day, Sunday, KCFAPI had until the next business day or until 20 June 2022 within which to file a request for review.

⁵ An Act Strengthening the Insurance Industry, further amending Presidential Decree No 613, otherwise known as the "The Insurance Code", as amended by Presidential Decree Nos. 1141 1280, 1455, 1460, 1814, and 1981, and Batas Pambansa Blg. 874, and for Other Purposes.

⁶ Emphasis supplied.

Section 404 of the Insurance Code requires a mutual benefit association to first secure a license from the Insurance Commission before it may transact business as such.⁷ Pursuant to the Insurance Commission's digitally published list of regulated entities, KCFAPI has been listed as one of the mutual benefit associations with valid and existing Certificate of Authority as of 31 July 2022.⁸ Thus, KCFAPI is duly organized as a mutual benefit association and has been duly licensed by the Insurance Commission to operate and transact business as such.

Organization as a mutual benefit association does not automatically entitle an entity to income tax exemption

However, KCFAPI's organization as a mutual benefit association and its concurrent license from the Insurance Commission does not automatically entitle the same to income tax exemption under the Tax Code. KCFAPI must still comply with the requirements of the Tax Code and existing rules and regulations in order for its income to be exempt from tax, particularly for it to **operate as a non-stock, non-profit association**, assisting their members "through the provision of benefits through an established system of benefit payments to its members and their dependents."⁹

Pursuant to Revenue Memorandum No. 038-2019,¹⁰ Section 30 (C) organizations or corporations must be actually operated either as:

- "a) A fraternal organization under the lodge system or a mutual aid association providing for the exclusive benefit of the members,

⁷ "SECTION 404. **A mutual benefit association, before it may transact as such, must first secure a license from the Commissioner.** The application for such license shall be filed with the Commissioner together with certified true copies of the articles of incorporation or the constitution and bylaws of the association, and all amendments thereto, and such other documents or testimonies as the Commissioner may require.

"No license shall be granted to a mutual benefit association until the Commissioner shall have been satisfied by such examination as he may make and such evidence as he may require that the association is qualified under existing laws to operate and transact business as such. The Commissioner may refuse to issue a license to any mutual benefit association if, in his judgment, such refusal will best promote the interest of the members of such association and of the people of this country. xxx Every association receiving any such license shall be subject to the supervision of the Commissioner: xxx

⁸ List of Mutual Benefit Associations with valid and existing Certificate of Authority as of 31 July 2022. Accessed at <https://www.insurance.gov.ph/mutual-benefit-associations/> on 5 September 2022.

⁹ Revenue Memorandum Order No. 038-2019. Subject: Tax Exemption of Non-Stock, Non-Profit Corporations under Section 30 of the National Internal Revenue Code of 1997, As Amended, dated 24 July 2019.

¹⁰ *Id.*

or a non-stock corporation organized by employees providing for the payment of life, sickness, accident, or other benefits exclusively to the members of such society, order, or association, or non-stock corporation or their dependents; and

- b) It should have an established system of benefit payments to its members and their dependents or established system for the payment of life, sickness, accident, or other benefits to its members or their dependents."

Additionally, the organization or corporation must be non-profit as any of their activities conducted for profit is taxable by virtue of the catch-all provision under Section 30 of the NIRC, as amended, which states:

"Notwithstanding the provisions in the preceding paragraphs, the income of whatever kind and character of the foregoing organizations from any of their properties, real or personal, or from any of their activities conducted for profit regardless of the disposition made of such income, shall be subject to tax imposed under this Code."

As jurisprudentially settled, non-profit means *"no net income or asset accrues to or benefits any member or specific person, with all the net income or asset devoted to the institution's purposes and all its activities conducted not for profit."*¹¹ Otherwise stated, if the net income or asset of the organization or corporation benefits any member or specific person, such inurement would negate claims that the entity is non-profit.

The non-inurement condition

In denying KCFAPI's request for tax-exemption under Section 30 (C) of the Tax Code, as amended, the BIR justified that KCFAPI violated the non-inurement condition for Section 30 organizations and corporations, which is clarified under RMC No. 51-2014,¹² as follows:

¹¹ Commissioner of Internal Revenue (CIR) v. St. Luke's Medical Center, Inc., (SLMC) G.R. No. 200688 (Notice). 15 April 2015, as reiterated in CIR v. SLMC. G.R. No. 203514. 13 February 2017. 805 PHIL 607-627.

¹² Subject: Clarifying the Inurement Prohibition under Section 30 of the National Internal Revenue Code of 1997

“xxx Therefore, in order for an entity to qualify as a non-stock and/or non-profit corporation/association/organization exempt from income tax under Section 30 of the NIRC, as amended, its earnings or assets shall not inure to the benefit of any of its trustees, organizers, officers, members or any specific person. The following are considered "inurements" of such nature:

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3. The provision of welfare aid and financial assistance to its members. An organization is not exempt from income tax if its principal activity is to receive and manage funds associated with savings or investment programs, including pension or retirement programs. **This does not cover a society, order, association, or non-stock corporation under Section 30 (C) of the NIRC providing for the payment of life, sickness, accident and other benefits exclusively to its members or their dependents;**¹³

The BIR ruled that KCFAPI is not exempt from income tax since it receives and manages funds associated with savings or investment programs, which is a form of inurement and is not allowed in a society, order, association or non-stock corporation under Section 30 (C) of the NIRC, as amended.

As correctly pointed out by KCFAPI, however, RMC No. 051-2014 admits an exception, such that the prohibition on receiving and managing of funds associated with savings or investment programs shall **not cover society, order, association, or non-stock corporation under Section 30 (C) of the NIRC providing for the payment of life, sickness, accident and other benefits exclusively to its members or their dependents.**

As mentioned under RMO No. 038-2019, Section 30 (C) organizations or corporations are required to have an **established system of benefit payments** to its members and their dependents or an established system for the payment of life, sickness, accident, or other benefits to its members or their dependents. Naturally, these entities will receive and manage funds from payments of the members' assessments or contributions and such other funds associated with savings or investment programs. As such, **KCFAPI's receipt and management of**

¹³ Emphasis supplied. As also cited in RMO No. 038-2019. *Supra fn no. 7.*

funds associated with savings or investment programs is not a violation of the non-inurement provision under RMC No. 51-2014.

Management of funds associated with savings or investment programs includes declaration of dividends to members

The BIR also ruled that KCFAPI cannot qualify as a non-stock, non-profit corporation under Section 30 (C) of the NIRC, as amended, as it declares dividends from surplus - a distribution of KCFAPI's net income - that negates the very essence of non-stock, non-profit organizations or corporations. Accordingly, this constraint on non-distribution of surplus is what distinguishes non-stock non-profit entities from for-profit or business entities.

A careful review of Article XIV of KCFAPI's submitted By-Laws reveal the manner on how the association manages the funds and the conditions of dividends payments from surplus, as part of the overall fund management process, thus:

Article XIV - Surplus & Dividends

Sec. 1. The Board of Trustees shall, from time to time, upon a majority vote, declare dividends from surplus, if in their judgment and upon the advice of the Actuary it is deemed advisable to do. Payments shall be made by reduction of the assessments or contributions of the members in any one year or by any other method subject to the discretion of the Board of Trustees.¹⁴

Sec. 2. Surplus of the Association may be distributed in the following manner:

- a. Not less than fifty percent (50%) of the surplus may be returned to the members in the form of dividends for reduction of the assessment or contribution or in such form of which the Board of Trustees may prescribe.

¹⁴ Emphasis supplied

- b. The balance may be given to the Knights of Columbus Foundation, which would be set up for the purpose of religious, educational, social, relief, war relief, public relief or any charitable work.

In connection with this, Notes 11 and 26 to KCFAPI's 2021 Audited Financial Statements provide:

Note 11 - Members' participation payable

Members' participation payable pertains to dividends attributable to members, of which majority of the balance are left to accumulate and held in-trust as opted by the benefit certificate¹⁵ holders. Dividends are paid out, applied to premium outstanding or accumulated at the option of the policyholder.¹⁶

Members' participation payable amounted to P127,940,142 as at December 31, 2021 (2020 - P149,057,802). Participation of benefit certificate holders amounted to P13,000,000 in December 31, 2021 (2020-P46,300,000).

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Note 26 - Summary of significant accounting and financial reporting policies

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26.5.12 Members' participation payable

DPF [(discretionary participation feature)] is a contractual right that gives benefit certificate holders the right to receive supplementary discretionary returns through participation in the surplus arising from participation business. **These returns are subject to the discretion of the Company and are within the**

¹⁵ Article VIII of KCFAPI's By-Laws provides:

Article VIII - Amount.

Sec. 1. Benefit Certificates issued shall be in the amount of P500.00, P1,000.00, and P3,000.00, except as otherwise decided by the Board of Trustees.

Sec. 2. More than one certificate may be issued to any one member.

¹⁶ Emphasis supplied.

constraints of the terms and conditions of the benefit certificate.¹⁷

Participation of benefit certificate holders during the year is taken to profit or loss. Amount not yet paid to the members as of reporting date is presented as "Member's Participation Payable."

26.5.13 Unappropriated surplus

Unappropriated surplus represents accumulated earnings of the Company less dividends declared.

We also note KCFAPI's representation that this distribution of dividends from surplus is explicitly allowed under Section 408 of the Insurance Code, which reads:

"SECTION 408. The constitution or bylaws of a mutual benefit association must distinctly state the purpose for which dues and/or assessments are made and collected and the portion thereof which may be used for expenses.

"Death benefit and other relief funds shall be created and used exclusively for paying benefits due the members under their respective membership certificates. A general fund shall likewise be created and used for expenses of administration of the association.

"A mutual benefit association shall only maintain free and unassigned surplus of not more than twenty percent (20%) of its total liabilities as verified by the Commissioner. **Any amount in excess shall be returned to the members by way of dividends, enhancing the equity value or providing benefits in kind and other relevant services.** In addition, subject to the approval of the Commissioner, a mutual benefit association may allocate a portion for capacity building and research and development such as developing new products and services, upgrading and improving

¹⁷ Emphasis supplied.

operating systems and equipment and continuing member education.”¹⁸

More importantly, the dividend contemplated as applying to mutual benefit associations is very much different from the distribution of profits as provided under the Revised Corporation Code¹⁹ for stock corporations.

Under Circular Letter No. 2015-48 dated 8 September 2015, the Insurance Commission issued the rules governing Section 408, paragraph 3 and defined dividends as follows:

Section 2. Definition of Terms. As used here, and unless the context otherwise requires, the following terms shall have the respective meaning hereinafter set forth or indicated:

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d) **Dividends.** - This term shall be construed to mean as **any additional benefit, whether in cash or in kind, given to the members of an MBA. The term shall not be construed as dividends for stock corporations as defined under the Corporation Code of the Philippines** and as dividends payable, if any, under a participating plan.²⁰

By virtue of these provisions, **mutual benefit associations are legally allowed to declare dividends from their surplus, specifically give out additional benefit, whether in cash or in kind to their members, and as mentioned above, the same shall not be construed as dividends for stock corporations as defined under the Corporation Code of the Philippines.**

Verily, the mutual benefit association could remain to be a non-stock and non-profit entity, provided that it shall manage funds associated with savings and investment programs for the exclusive benefit of its members or their dependents.

¹⁸ Emphasis supplied.

¹⁹ Republic Act No. 11232, otherwise known as the “Revised Corporation Code of the Philippines”

²⁰ Emphasis Supplied. Section 2 (D) of Insurance Commission Circular Letter No. 2015-048. Subject: Rules in the Application of Section 408, Paragraph 3 of the Amended Insurance Code on Free and Unassigned Surplus.

In view of the foregoing, this Office grants the request for review. Kindly note that this ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it shall be disclosed that the facts are different, then this ruling shall be considered as null and void.

Thank you.

Very truly yours,


BENJAMIN E. DIOKNO
Secretary



OCT 17 2022



CC: **HON. LILIA CATRIS GUILLERMO**
Commissioner, Bureau of Internal Revenue