REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MALAYAN REINSURANCE CORPORATION (formerly EASTERN GENERAL REINSURANCE CORPORATION),
Petitioner,

- versus -

C.T.A. CASE NO. 6471

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JAN 26 2004

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DECISION

This case involves a claim for refund or issuance of tax credit certificate in the total amount of P548,750.00 allegedly representing 20% final taxes erroneously withheld by the Bureau of Treasury on the interest income derived by petitioner from its investments in long-term treasury notes.

Petitioner is a corporation organized and existing under and by virtue of the laws of the Philippines, with principal office at Yuchengco Tower, 500 Q. Paredes St., Binondo, Manila.[1]

In 1996, petitioner purchased treasury notes issued by the Bureau of Treasury with the following details:

Treasury Note	ISIN #	Issue Date	Maturity Date	Principal	Interest Rate	Semi-annual Interest Payment
FXTN7-2	PIBD0703B029	29 Feb 96	28 Feb 03	P5,000,000	15.375%	P384,375
FXTN 10-1	PIBD1006I010	26 Sep 96	26 Sep 06	P5,000,000	16.000%	P400,000

[1] Joint Stipulation of Facts, par. 1.

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For the months of August and September of 2000 and March, August and September of 2001, the Bureau of Treasury allegedly paid interest and withheld taxes thereon at the following rates:

Treasury Note ISIN	Interest Payment Date	Total Interest Payable	20% Withholding Tax	Net Amount Paid to Malayan
PIBD0703B029	28 Aug 00	P384,375	P 76,875	P307,500
PIBD0703B029	28 Aug 01	384,375	76,875	307,500
PIBD1006I010	27 Sep 00	400,000	80,000	320,000
PIBD1006I010	26 Mar 01	400,000	80,000	320,000
PIBD1006I010	27 Sep 01	400,000	80,000	320,000
PIBD1009IA118	13 Sep 00	387,500	77,500	310,000
PIBD1009IA118	13 Sep 01	387,500	77,500	310,000
	TOTAL WITHHOLDING TAX		**P548,750**	

It is the position of the petitioner that pursuant to Section 32(B)(7)(g) of the Tax Code, as amended, gains realized from the sale or exchange or retirement of bonds, debentures or other certificate of indebtedness with a maturity of more than five (5) years are excluded from taxable income. Thus, the above interest income is exempt from the 20% final withholding tax on deposits and deposit substitutes considering that the same constitutes gain from the sale of bonds, debentures and certificates of indebtedness with a maturity of more than five (5) years.

Consequently, on April 18, 2002, petitioner wrote a letter to the respondent requesting for a refund of P548,750.00 corresponding to the tax withheld by the Bureau of Treasury on the subject treasury notes.[2] Petitioner likewise relied on BIR Ruling No. 166-99 (October 25, 1999) wherein it was opined that interest income realized from

[2] *Ibid*, par. 3.

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government securities with a maturity of more than five (5) years are exempt from withholding tax. Respondent has not taken any action on petitioner's letter claim for refund; hence, petitioner timely filed the instant petition on April 29, 2002.[3]

By way of an Answer, respondent raised the following Special and Affirmative Defenses, to wit:

a) The petition does not state a cause of action as there is no allegation that the tax sought to be refunded was actually remitted to the Bureau of Internal Revenue in accordance with the provisions of the Tax Code;

b) Petitioner erroneously concluded that the interest income which was subjected to 20% withholding tax constitutes gain from the sale of bonds, debentures and certificates of indebtedness;

c) Granting without admitting, that petitioner's interest income was subjected to 20% withholding tax, the same is presumed to have been collected in accordance with law;

d) The petition is premature considering that the petitioner's application for the refund/tax credit of the alleged erroneous withholding tax of P548,750.00 which was only received by Revenue District Office No. 34 on April 18, 2002, is still pending investigation by the said Office;

e) Claim for refund is construed strictly against the claimant and cannot be allowed unless proven explicitly and categorically; and

f) The allegations regarding tax refundability do not *ipso facto* merit the refund claimed.

To support its claim, petitioner submitted numerous documents and likewise presented witnesses to identify the same. Respondent, on the other hand, submitted the case for decision based on the pleadings.[4]

The parties jointly stipulated the issues to be resolved by this court, *viz*:

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[3] Id., pars. 6 & 7.
[4] CTA Records, page 107.

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(1) Whether or not interest income derived from treasury notes which have a maturity in excess of five years is exempt from the 20% withholding tax;

(2) Whether or not the treasury notes purchased by petitioner from the Bureau of Treasury through Government Securities Eligible Dealers (GSEDs) can be considered as bonds, debentures or certificates of indebtedness under the Tax Code;

(3) Whether or not the Bureau of Treasury paid interest on the treasury notes and withheld the tax at the rate of 20% of the interest payment in the total amount of P548,750.00; and

(4) Whether or not petitioner is entitled to a refund/tax credit on the amount withheld on such interest payment amounting to P548,750.00.

The issue of whether or not interest income derived from treasury notes which have a maturity in excess of five years is exempt from the 20% withholding tax is not novel. This court has consistently ruled that only the gain from sale (*as distinguished from interest*) of bonds, debentures or other certificates of indebtedness with maturity of more than five years shall be exempt from income tax. Therefore, interest income earned from investments in long-term fixed rate treasury notes are subject to 20% withholding tax.[5] This issue has been first passed upon by this court in the case of ***Nippon Life Insurance***

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[5] ***Malayan Reinsurance Corp. (formerly Eastern General Reinsurance Corp.) vs. CIR***, CTA Case No. 6252, July 24, 2002; ***Malayan Zurich Ins. Co., Inc. vs. CIR***, CTA Case No. 6251, Sept. 30, 2002; ***First Nationwide Assurance Corp. vs. CIR***, CTA Case No. 6253, Oct. 3, 2002; ***RCBC vs. CIR***, CTA Case No. 6228, Dec. 4, 2002; ***Malayan Ins. Co., Inc. vs. CIR***, CTA Case No. 6243, Dec. 16, 2002; ***Tokio Marine Malayan Ins. Co., Inc. (formerly Pan Malayan Ins. Corp.) vs. CIR***, CTA Case No. 6254, Jan. 13, 2003; ***RCBC Savings Bank, Inc. vs. CIR***, CTA Case No. 6341, May 5, 2003; ***Nippon Life Ins. Co. of the Phils., Inc. vs. CIR***, CTA No. 6323, July 24, 2003; ***Nippon Life Ins. Co. of the Phils., Inc. vs. CIR***, CTA Case No. 6289, September 22, 2003; ***Nippon Life Ins. Co. of the Phils., Inc. vs. CIR***, CTA Case No. 6348, September 12, 2003; ***Tokio Marine Malayan Ins. Co., Inc. (formerly Pan Malayan Ins. Corp.) vs. CIR***, CTA Case No. 6472, Dec. 1, 2003; ***First Nationwide Assurance Corp. vs. CIR***, CTA Case No. 6473, Dec. 22, 2003.

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Company of the Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6142, February 4, 2002, wherein we held that:

> "Rulings issued by the Commissioner of Internal Revenue command respect and weight. However, such rulings are not conclusive upon the courts and will be ignored if found to be erroneous. Hence, in the case of **Philippine Bank of Communications vs. Commissioner of Internal Revenue, G.R. No. 112024, January 28, 1999,** our Supreme Court, in disregarding a Revenue Memorandum Circular issued by the Commissioner of Internal Revenue, held:
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> > "It bears repeating that Revenue memorandum-circulars are considered administrative rulings (in the sense of more specific and less general interpretations of tax laws) which are issued from time to time by the Commissioner of Internal Revenue. It is widely accepted that the interpretation placed upon a statute by the executive officers, whose duty is to enforce it, is entitled to great respect by the courts. Nevertheless, such interpretation is not conclusive and will be ignored if judicially found to be erroneous. Thus, courts will not countenance administrative issuances that override, instead of remaining consistent with, the law they seek to apply and implement."
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In this case, We conclude that the aforementioned BIR rulings are erroneous. Such rulings were based on the mistaken belief that the term "gains" as used in Section 32(B)(7)(g) of the Tax Code include interest.

It is a well-settled rule of statutory construction that tax exemptions are strictly construed against the taxpayer. Consequently, where Section 32(B)(7)(g) of the Tax Code, which grants tax exemption, is susceptible of a restrictive interpretation, such interpretation must be adopted.

We take the view that "gains" as the term is used therein in Section 32(B)(7)(g) of the Tax Code cannot include interest since it clearly refers to *gains from the sale* of bonds, debentures and other certificates of indebtedness.

Initially, it must be pointed out that whereas the term "gains" includes "interest" as a general rule, this rule cannot be applied to Section

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32(B)(7)(g) of the Tax Code which particularly refers to *"Gains from the Sale of Bonds, Debentures or other Certificate of Indebtedness"* in its title and "Gains realized from the sale or exchange or retirement of bonds, debentures and other certificate of indebtedness with a maturity of more than five (5) years" in its body. Stated otherwise, Section 32(B)(7)(g) of the Tax Code specifically refers to *gains from the sale* of bonds, debentures and other certificates of indebtedness as contradistinguished from the term "gains" in its general sense, which is synonymous to income."

In this regard, Section 32(A) of the Tax Code defines "gross income" as follows:

Section 32. *Gross Income*. -

(A) *General Definition*. – Except when otherwise provided in this Title, gross income means all income derived from whatever source, including (but not limited to) the following items:

(1) Compensation for services in whatever form paid, including, but not limited to fees, salaries, wages, commissions and similar items;
(2) Gross income derived from the conduct of trade or business or the exercise of profession;
(3) Gains derived from dealings in property;
(4) Interests;
(5) Rents;
(6) Royalties;
(7) Dividends;
(8) Annuities;
(9) Prizes and winnings;
(10) Pensions; and
(11) Partner's distributive share from the net income of the general professional partnership.

From the aforequoted Section 32(A) of the Tax Code, it is clear that there is a distinction between "gains derived from dealings in property" and "interests", which are separately classified as items of gross income. "Gains realized from the sale or exchange or retirement of bonds, debentures and other certificate of indebtedness" would fall under the category of "gains derived from dealings in property". On the other hand, "interests" would include interest from bonds, debentures and other certificate of indebtedness. Gain realized from the sale or exchange or retirement of bonds, debentures and other certificate of indebtedness and interest from bonds, debentures and other certificate of indebtedness fall under separate and distinct income categories."

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> There is a clear distinction between interest from bonds and gain from the sale of bonds. It is only the "Gains realized from the sale or exchange or retirement of bonds, debentures or other certificate of indebtedness with a maturity of more than five (5) years" that is excluded from gross income and thus exempt from income tax under Section 32(B)(7)(g) of the Tax Code. Such gains from sale or exchange or retirement of bonds, debentures or other certificate of indebtedness fall within the general category of "Gains derived from dealings in property", as distinguished from interest from bonds, debentures or other certificate of indebtedness, which fall within the general category of "Interests" under Section 32(A) of the Tax Code.

It is worth emphasizing that our ruling in the above case was affirmed *in toto* by the Court of Appeals in the case of ***Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue, CA-G.R. SP No. 69224, November 15, 2002,*** where it enunciated that:

> "The CTA is absolutely correct. Income is the flow of money to an individual or corporation within a specified time, as payment for services, interests, or profits from investments. Income is the return in money from one's business, labor or capital invested. The famous analogy used by the Supreme Court described property, labor and capital as trees and income as their fruits. Thus, income is synonymous with profit or gain. Nippon used this general concept of income or gain to include interest within the meaning of Section 32(B)(7)(g). This strained interpretation suffers from serious flaws.
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> First, while the Tax Reform Act adhered to the above definition of income, it also classified income into the following categories: compensation for services, income derived from the conduct of business or exercise of profession, gains derived from dealings in property, interest, rents, royalties, dividends, annuities, prizes and winnings, pensions, and a partner's distributive share from net income of a general professional partnership. Section 32(B)(7)(g) clearly refers to gains realized from the sale, exchange or retirement of bonds, among others, with a maturity date of more than five (5) years. There is no reason to confuse gains from sale of bonds with gains in the general sense of income. Nippon argued that the law did not qualify the term "gains" but it is impossible not to see that the law did qualify such term and restricted it to gains from sale of bonds.

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> Section 32(B) enumerates the exclusions from gross income. Exclusions, like tax exemptions, are highly disfavored in law. A person claiming a tax exemption must justify his claim by the clearest terms possible because an exemption from the common burden of taxation is not allowed upon vague implications but on language too plain, to be mistaken. In the instant case, Nippon's claimed exclusion runs counter to the plain, unequivocal language of the law. It resorted to the legislative intent behind the provision to justify departure from the literal meaning but we all know this is prohibited. The only intent that must be given effect is the one expressed in the language of the statute. If a statute is clear, plain and free from ambiguity, it must be given its literal meaning and applied without attempted interpretation. To depart from the meaning expressed by the words of the statute is to alter the statute and legislate, not to interpret. A statute which is plain, clear and free from doubt is not subject to construction; there is no need for interpretation, only application.
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> In enacting the Tax Reform Act, the legislature may have intended to develop the capital market and encourage savings in long-term investments but even under the restrictive interpretation that gains under the subject provision means gains from sale of bonds, debentures and other certificates of indebtedness, such legislative intent still finds full expression. Section 32(B)(7)(g) as written and as interpreted by the CTA is still an incentive to the development of the bond market because it excludes gains from sales from the computation of the gross income. This may not be as sweeping as Nippon would have wanted to but it is an incentive nonetheless, which is faithful to the legislative intent. Nippon's all or nothing stance on the exclusion of gains from bonds finds no support in either the language or intent of the law.

In view of the foregoing discussions, it is clear that the tax exemption from final withholding tax granted under Section 32(B)(7)(g) of the Tax Code, as amended, is limited only to gain from sale of long-term investments. Inasmuch as the claim of the petitioner is for the refund of the 20% final tax on interest income earned by it from investments in long-term treasury notes, the same has no legal basis. Accordingly, petitioner is not entitled to the claim sought for. It follows that the resolution of the remaining issues is no longer necessary.

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WHEREFORE, in view of the foregoing, the instant petition is hereby **DENIED** for lack of merit.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Judge

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge