REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MALAYAN ZURICH INSURANCE COMPANY, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 6474

COMMISSIONER OF INTERNAL, REVENUE,
Respondent.

Promulgated:

SEP 0 2 2004

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D E C I S I O N

This is a Petition for Review to compel respondent to issue a tax credit certificate for alleged erroneous withholding of tax by the Bureau of Treasury on interest payments paid to the petitioner in connection with its purchase of treasury notes with a maturity of more than five (5) years on the ground that interest income realized from government securities with a maturity of more than five (5) years are exempt from withholding taxes.

Petitioner is a corporation organized and existing under and by virtue of the laws of the Philippines, with principal offices at Yuchengco Tower, 500 Q. Paredes St., Binondo, Manila *(Paragraph 2, Petition for Review)*.

In 1996, 1998 and 1999, petitioner purchased Fixed Rate Treasury Notes (FXTNs) issued by the Bureau of Treasury with the following details *(Paragraph 4, Petition for Review)*:

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Treasury Note	ISIN #	Issue Date	Maturity Date	Principal	Interest Rate	Semi-annual Interest Payment
FXTN 7-4	PIBD0703E044	30 May 96	30 May 03	P 4,850,000	15.375%	P 372,843.75
FXTN 7-5	PIBD0703C051	25 Jul 96	25 Jul 03	P 3,500,000	15.750%	P 275,625
FXTN 10-1	PIBD1006I010	26 Sep 96	26 Sep 06	P 5,000,000	16.000%	P 400,000
FXTN 10-4	PIBD1007K042	27 Nov 97	27 Nov 07	P10,000,000	22.875%	P1,143,750
FXTN 10-7	PIBD1008KT29	26 Nov 98	26 Nov 08	P 3,500,000	17.800%	P 311,500

For the period covering May 26, 2000 to December 1, 2001, the Bureau of Treasury paid interest for the said treasury notes to petitioner and withheld taxes thereon at the following rates *(Paragraph 5, Petition for Review)*:

Treasury Note ISIN	Interest Payment Date	Total Interest Payable	20% Withholding Tax	Net Amount Paid to Malayan
PIBD0703E044	31 May 00	P 372,843.75	P 74,568.75	P 298,275
PIBD0703E044	1 Dec 00	P 372,843.75	P 74,568.75	P 298,275
PIBD0703E044	31 May 01	P 372,843.75	P 74,568.75	P 298,275
PIBD0703E044	1 Dec 01	P 372,843.75	P 74,568.75	P 298,275
PIBD0703G051	26 Jul 00	P 275,625.00	P 55,125.00	P 220,500
PIBD0703G051	26 Jul 01	P 275,625.00	P 55,125.00	P 220,500
PIBD1006I010	27 Sep 00	P 400,000.00	P 80,000.00	P 320,000
PIBD1006I010	26 Mar 01	P 400,000.00	P 80,000.00	P 320,000
PIBD1006I010	27 Sep 01	P 400,000.00	P 80,000.00	P 320,000
PIBD1007K042	27 May 00	P1,143,750.00	P228,750.00	P 915,000
PIBD1007K042	29 Nov 00	P1,143,750.00	P228,750.00	P 915,000
PIBD1007K042	27 May 01	P1,143,750.00	P228,750.00	P 915,000
PIBD1007K042	29 Nov 01	P1,143,750.00	P228,750.00	P 915,000
PIBD1008KT29	26 May 00	P 311,500.00	P 62,300.00	P 249,200
PIBD1008KT29	26 Nov 00	P 311,500.00	P 62,300.00	P 249,200
PIBD1008KT29	26 May 01	P 311,500.00	P 62,300.00	P 249,200
PIBD1008KT29	26 Nov 01	P 311,500.00	P 62,300.00	P 249,200
TOTAL WITHHOLDING TAX			**P 1,812,725.00**	

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Contesting the imposition of the withholding tax on said interest payments, petitioner, on April 29, 2002, wrote a letter addressed to the respondent requesting that a refund or a tax credit in the amount of ONE MILLION EIGHT HUNDRED TWELVE THOUSAND SEVEN HUNDRED TWENTY FIVE (P1,812,725.00) PESOS, representing the tax withheld by the Bureau of Treasury on the said FXTNs be issued by the respondent in its favor *(Exhibit Z)*. The instant petition was filed by petitioner on the same day.

By way of an Answer filed on May 23, 2002, respondent asserted the following Special and Affirmative Defenses, and posited that:

> "6. Petitioner's alleged claim for tax refund/tax credit is subject to administrative investigation/examination by the respondent's Bureau.
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> 7. Petitioner failed to demonstrate that the tax subject of the case at bar was erroneously or illegally collected.
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> 8. Taxes paid and collected are presumed to have been paid in accordance with law and regulations, hence, not refundable.
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> 9. It is incumbent upon petitioner to prove that it has complied with the governing rules relative to tax recovery or refund as provided for under Sections 204 and 212 of the Tax Code, as amended.
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> 10. In an action for tax refund/credit, the burden of proof is on the taxpayer to establish its right to refund, and failure to adduce sufficient proof is fatal to the action for tax refund/credit.
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> 12. Finally, there is no way to dispute the cardinal rule in taxation that tax exemptions are highly disfavored in law and he who claims tax exemption must be able to justify his claim or right. The exemption cannot be established by mere implication but it must be clearly expressed. (Wonder Mechanical Engineering Corporation vs. Court of Tax Appeals, et al., 64 SCRA 555)."

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 without presenting any evidence *(page129, CTA Records)*.

The parties jointly stipulated the following issues to be resolved by the court, to wit:

1. Whether or not interest income derived from treasury notes which have 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 P1,812,725.00;

4. Whether or not Petitioner is entitled to a refund/tax credit on the amount withheld on such interest payment amounting to P1,812,725.00.

This court is once again called upon to decide on the issue of whether or not interest payments on treasury notes with maturity date of more than five (5) years are taxable within the contemplation of the Tax Code.

This is not a novel issue. This court has always been consistent in ruling that interest income derived from treasury notes which have a maturity in excess of five (5) years is not exempt from the 20% withholding tax. This much is a settled matter. As previously enunciated in numerous cases, this court has uniformly 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.

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Therefore, interest income earned from investments in long-term fixed rate treasury notes are subject to 20% withholding tax.

Time and again, this court has always been guided by the principles laid down 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,*** wherein the Court of Appeals affirmed *in toto* this court's ruling on said issue, when 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.

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."

Furthermore,

"In interpreting this provision, the word 'gain' must be understood in its meaning in relation to words to which it was associated. Thus, gains must not be interpreted in its generic sense as that referred to under *Section 32 (A)* of the *Tax Code* but in the sense it was used under the specific provision of *Section 32 (B) (7) (g)* of the same *Tax Code.* Since gain was specifically referred to as gains from sale, it cannot be construed as to include gains derived in any other manner than by sale. The rule in statutory construction is that words employed in a statute are interpreted in connection with, and their meaning is ascertained by reference to the words and the phrases with which they are associated or related *(Ang Bagong Bayani-OFW Labor Party vs. COMELEC, 359 SCRA 698).*

Gain has a general meaning. However, where there is a particular or special provision in the statute and also a general one, the special provision prevails in the sense that the general provisions cannot derogate from the special. x x x *(Uy vs. Sandiganbayan, 354 SCRA 651).* Hence, the meaning of 'gain' as used in *Section 32 (B) (7) (g)* of the *Tax Code* shall prevail over that of *Section 32 (A).*

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> We agree with the CTA that if the concept of gains from sale includes interest income, then the two terms should not have been treated separately in the enumeration of gross income under *Section 32 (A).* In this regard, it has been the long standing policy and practice to respect conclusions arrived at by quasi-judicial agencies, especially the court of Tax Appeals which, by the nature of its functions, is dedicated exclusively to the study and consideration of tax problems, and which has thus developed an expertise on the subject, unless an abuse or improvident exercise of its authority is shown *(Commissioner of Internal Revenue vs. CA, 303 SCRA 508)*." ***(Tokio Marine Malayan Insurance Company, Inc. [Formerly Pan Malayan Insurance Corporation] vs. Commissioner of Internal Revenue, CA-G.R. SP No. 77639, June 29, 2004)***

This ruling of the Court of Appeals has been affirmed by the Supreme Court in a resolution promulgated on November 19, 2003 in the case of ***Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue, G.R. No. 159612.***

Moreover, relevant to the present discussion, this court reiterates its dissertation on the subject matter, where it declared 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. <u>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.'</u>

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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 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 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) <u>Gains derived from dealings in property</u>;
(4) <u>Interests</u>;
(5) Rents;
(6) Royalties;

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(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 ***(Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue, G.R. No. 159612, November 19, 2003, CA-G.R. SP No. 69224, November 15, 2002, CTA Case No. 6142, February 4, 2002; Malayan Reinsurance Corporation [Formerly Eastern General Reinsurance Corporation] vs. Commissioner of Internal Revenue, CTA Case No. 6471, January 26, 2004)***."

Clearly, based on the foregoing lengthy and exhaustive discussion, there is a world of difference between the gains derived from dealings in property in long term investments which are covered by the incentives provided by law and therefore tax

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exempt *vis-a-vis* the interest payments as defined under the Tax Code which are taxable. Thus, it could be seen with pristine clarity 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. Accordingly, petitioner is not entitled to the claim sought for. Therefore, resolution of the remaining issues is rendered moot and academic.

IN LIGHT OF THE FOREGOING, petitioner's claim for refund of the 20% final tax on interest income earned by it from investments in long-term treasury notes is hereby **DENIED** for lack of merit.

SO ORDERED.

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

WE CONCUR:

(On Official Leave)
ERNESTO D. ACOSTA
Presiding Justice

LOVELL R. BAUTISTA
Associate Justice

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.

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

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