REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MALAYAN ZURICH
INSURANCE COMPANY, INC.,
Petitioner,

- versus - C.T.A. CASE NO. 6251

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

Promulgated:

SEP 3 0 2002

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DECISION

This is a claim for refund or issuance of tax credit certificate in the amount of **NINE HUNDRED FORTY SIX THOUSAND THREE HUNDRED SIXTY TWO AND 50/100 PESOS (P946,362.50)** allegedly representing the 20% final tax erroneously withheld by the Bureau of Treasury on the interest payments made to petitioner in connection with the latter's investment in Fixed Rates Treasury Notes (FXTN) with maturity of more than five (5) years.

Based on the records, the antecedent facts of the case are as follows:

Petitioner Malayan Zurich Insurance Company, Incorporated is a corporation organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office at Yuchengo Tower, 500 Q. Paredes Street, Binondo, Manila.

From 1996 to 1998, MZIC purchased Fixed Rates Treasury Notes issued by the Bureau of Treasury with the following details:

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ISIN No.	Series	Value Date	Issue Date	Maturity Date	Tenor	Face Amount
PIBD0703E044	7-4	July 22, 1996	May 30, 1996	May 30, 2003	7	P4,850,000.00
PIBD0703G051	7-5	July 25, 1996	July 25, 1996	July 25, 2003	7	3,500,000.00
PIBD10061010	10-1	Sept. 26, 1996	Sept. 26, 1996	Sept. 26, 2006	10	5,000,000.00
PIBD1007K042	10-4	Feb. 17, 1999	Nov. 27,1997	Nov. 27, 2007	10	10,000,000.00
PIBD1008KT29	10-7	Feb. 15, 1999	Nov. 26, 1998	Nov. 26, 2008	10	3,500,000.00
Total						**P26,850,000.00**

The Bureau of Treasury paid interest for the said treasury notes to petitioner and withheld twenty percent (20%) final tax thereon in the sum of P946,362.50, broken down as follows:

Treasury Notes	Exhibit	Interest payment date	Total interest payable	20% Final Tax Withheld	Net amount paid to MZIC
FXTN 7-4	G-3,G-4	30 May '99	P 372,843.75	P 74,568.75	P 298,275
	G-5,G-6	30 Nov. '99	372,843.75	74,568.75	298,275
FXTN 7-5	G-7,G-8	25 Jul. '99	275,265.00	55,125.00	220,500
FXTN 10-1	G-9,G-10	26 Mar. '99	400,000.00	80,000.00	320,000
	G-11,G-12	26 Sept. '99	400,000.00	80,000.00	320,000
FXTN 10-4	G-13,G-14	27 May '99	1,143,750.00	228,750.00	915,000
	G-15,G-16	27 Nov '99	1,143,750.00	228,750.00	915,000
FXTN 10-7	G-17, G-18	26 May '99	311,500.00	62,300.00	249,200
		26 Nov.'99	311,500.00	62,300.00	249,200

TOTAL TAX WITHHELD	**P946,362.50**

On March 19, 2001, petitioner wrote a letter addressed to the respondent requesting for the refund or tax credit in the amount of NINE HUNDRED FORTY SIX THOUSAND THREE HUNDRED SIXTY TWO AND 50/100 PESOS (P946,362.50), corresponding to the tax withheld by the Bureau of Treasury on its Fixed Rate Treasury Notes. In its letter, petitioner claimed that under Section 32 (B)(7)(g) of the National Internal Revenue Code of 1997, 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; therefore, the tax withheld by the Bureau of Treasury was erroneously made and should be refunded or credited.

As there was no immediate action on the part of the respondent, petitioner elevated the case to this court through a Petition for Review filed on March 23, 2001.

The court is tasked to resolve the following issues:

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1. Whether or not the interest derived from treasury notes which mature in excess of five years is exempt from twenty percent (20%) final withholding tax;
2. Whether or not the treasury notes purchased by petitioner from the Bureau of Treasury can be considered as bonds, debentures or certificates of indebtedness under the Tax Code;
3. Whether or not the claim for refund or tax credit of the petitioner in the amount of P946,362.50 is substantiated by documentary evidence.

Petitioner alleged that the interest income derived from its Fixed Rates Treasury Notes (FXTN) with maturity of more than five (5) years is exempt from twenty percent (20%) final withholding tax based on Section 32 (B)(7)(g) of the Tax Code. In addition, petitioner relied on respondent's BIR Ruling No. 166-99 dated October 25, 1999, pertinent portions of which are hereunder reproduced for easy reference:

> " xxx As a general rule, the interest income on currency bank deposit and yield or other monetary benefit from these "deposit substitutes" and similar arrangement derived by banks and non-bank financial intermediaries are being taxed at the final rate of 20% under Section 27 (D)(1) of the Tax Code.
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> However, Section 32 (B) (7) (g) of the 1997 Tax Code, provides an exception, thus:
>
> **Section 32**. *Gross Income*
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> xxx xxx xxx
>
> **(B.)** *Exclusions from Gross Income*- The following shall not be included in the gross income and shall be exempt from taxation under this Title:
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> xxx xxx xxx
>
> **(7)** *Miscellaneous items.*-
> xxx xxx xxx
>
> **(g)** *Gains from the Sale of Bonds, Debentures and Certificate of Indebtedness.*- Gains realized from the sale or

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> exchange or retirement of bonds, debentures or other certificate of indebtedness with maturity of more than five (5) years."

The idea therefore, is to still treat bonds, debentures, or other certificates of indebtedness as "deposit substitutes" the interest income, yield or gain derived therefrom subject to the 20% final tax under Section 27 (D)(1) of the 1997 Tax Code, but exclude said interest income, yield or gain from the gross income if the bonds, debentures or the certificate of indebtedness have maturities of more than five (5) years. Conversely, only the income derived on these debt instruments with maturity of more than five (5) years shall be excluded from the gross income.

Further, for purposes of income taxation, the interest income or yield earned from the sale of long-term bonds, whether discounted or added on, should be considered in determining the gain thus earned. The rationale behind this is that, the value of these long-term securities, is determined by the interest or yield that such securities pay, such that, a low interest earning bond cannot be sold for a higher price. The income tax on "gain" is levied in the difference between the sale price and the original purchase price, not the difference between the sale price and the market value on the stated date (Walsh vs. Brewster, Conn. 41 S. Ct. 392, 255, U.S. 536,65 L. Ed.762).

Furthermore, the term sale is not limited to the subsequent transfer of the instrument but to its origination and issuance, as well. Thus, **from the time of its issuance, we should consider the "income" which is actually the amount coming to a person within a specified time, whether as payment for the services, interest or profit from investment. Its usual synonyms being "gain," "profit," "revenue"** (Trefry v. Putnam, 116 N.E. 904, 907, 227 Mass. 522, L.R.A. 1917 F, 806. (Words and Phrases, Gain, page 11, Permanent Edition 18)"

Petitioner also cited BIR Ruling No. 016-00 issued on January 7, 2000, which confirmed its previous interpretation of Section 32(B)(7)(g). It states:

> "A. Section 32 (B)(7)(g) of the Tax Code of 1997 otherwise known as the NIRC of 1997 provides that "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 gross income, hence, exempt from income tax, effective January 1, 1998. Thus, if the maturity period of the bonds issued through the BTr will be more than five (5) years, the gains that may be derived therefrom by the

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> bondholders shall accordingly be exempt from income tax. Consequently, such gains are also exempt from the 20% final withholding tax.
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> D. Since the law speaks of the exclusion from gross income of all gains derived from long term investments, it follows that embraced thereunder are income, yield or interest, which are all synonymous with gains, whether discounted or at a premium. Thus, the exemption applies to interest/coupon or profit from the principal of such long-term regular or SDT bonds complying with the statutory maturity period."

On the basis of the above-quoted law and BIR Rulings, petitioner contended that interest income earned from Fixed Rates Treasury Notes (FXTN) should be included in the phrase " *gains realized from the sale, exchange or retirement of bonds, debentures and certificate of indebtedness*." Petitioner further alluded that interest income earned from such long term FXTN, whether discounted or added-on, which is the basis of the gain from these instruments, should be excluded from gross income. Consequently, it must be exempt from income tax. Otherwise, the "gain," which is synonymous with "yield or interest" which is excluded from the gross income will be non-existent or illusory, since the gain or value of these securities is determined by the interest or yield that such securities pay.

On the contrary, respondent maintained the view that petitioner is not entitled to the claim for refund for while as a general rule, "gains" includes "interest," this cannot be applied in Section 32 (B)(7)(g) of the Tax Code. The provision clearly refers to *gains from the sale* of bonds, debentures and other certificates of indebtedness.

A cursory review of the attendant circumstances reveals that the central controversy lies in the interpretation of the parties of Section 32(B)(7)(g) of the Tax Code.

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The issue presented is not novel. In the case of ***Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue,*** CTA Case No. 6142, promulgated on February 4, 2002, this court first passed upon the issue in this wise:

> "Notwithstanding the abovementioned rulings, We cannot agree with Petitioner's contention that interest on its long term investments should be considered gain exempt from income tax pursuant to Section 32(B)(7)(g) of the Tax Code.
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> 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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> x x x
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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.
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> 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."

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Moreover, in the said case, this court pointed out that whereas the terms "gains" includes "interest" as a general rule, this rule cannot be applied to Section 32 (B)(7)(g) of the 1997 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 certificates 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, thus:

"In this regard, Section 32(A) of the 1997 Tax Code defines "gross income" as follows:

SEC. 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;
(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.

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From the aforequoted Section 32(A) of the 1997 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."

Significantly, a similar ruling was promulgated by this court last July 24, 2002 in CTA Case No. 6252 entitled ***Malayan Reinsurance Corporation vs. Commissioner of Internal Revenue***. As in the case of Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue, *supra,* we emphasized that under Sections 24, 25, 27 and 28 of the Tax Code, in relation to Sections 31 and 32 of the Tax Code, there is no sweeping exemption from income tax of interest from bonds, debentures or other certificates of indebtedness with a maturity of more than five (5) years, thus:

"Moreover, Section 24 of the 1997 Tax Code governs the taxation of interest, including interest from deposits and yield from deposit substitutes and trust funds and similar arrangements, realized by citizens and resident aliens, which provides in pertinent part:

SEC. 24. *Income Tax Rates.* –

(A) *Rates of Income Tax on Individual Citizen and Individual Resident Alien of the Philippines.* –

(1) An income tax is hereby imposed:

(a) On the taxable income defined in Section 31 of this Code, other than income subject to tax under Subsections (B), (C) and (D) of this Section, derived for each taxable year from all sources within and without the Philippines by every individual citizen of the Philippines residing therein;

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(b) On the taxable income defined in Section 31 of this Code, other than income subject to tax under Subsections (B), (C) and (D) of this Section, derived for each taxable year from all sources within the Philippines by an individual citizen of the Philippines who is residing out of the Philippines, including overseas contract workers referred to in Subsection (C) of Section 23 hereof; and

(c) On the taxable income defined in Section 31 of this Code, other than income subject to tax under Subsections (B), (C) and (D) of this Section, derived for each taxable year from all sources within the Philippines by an individual alien who is a resident of the Philippines

The tax shall be computed in accordance with and at the rates established in the following schedule:

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(B) *Rate of Tax on Certain Passive Income.* –

(1) *Interests, Royalties, Prizes, and Other Winnings.* – A final tax at the rate of twenty percent (20%) is hereby imposed upon the amount of <u>interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust fund and similar arrangements;</u> x x x: *Provided, however,* That interest income received by an individual taxpayer (except a nonresident individual) from a depository bank under the expanded foreign currency deposit system shall be subject to a final income tax at the rate of seven and one-half percent (7%) of such interest income: *Provided, further,* That <u>interest income from long-term deposit or investment in the form of savings, common or individual trust funds, deposit substitutes, investment management accounts and other investments evidenced by certificates in such form prescribed by the Bangko Sentral ng Pilipinas (BSP) shall be exempt from the tax imposed by this Subsection</u>: *Provided, finally,* That should the holder of the certificate preterminate the deposit or investment before the fifth (5^{th}) year, a final tax shall be imposed on the entire income and shall be deducted and withheld by the depository bank from the proceeds of the long-term deposit or investment certificate based on the remaining maturity thereof:

Four (4) years to less than five years	- 5%
Three (3) years to less than four years	- 12%
Less than three (3) years	- 20%

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On the other hand, Section 25(A)(1) and (2) of the 1997 Tax Code taxes nonresident alien individuals engaged in trade or business within the Philippines on interest realized from Philippine sources in the same manner as citizens and resident alien individuals taxed under the aforequoted Section 24(A) and 24(B)(1), to wit:

SEC. 25. *Tax on Nonresident Alien Individual.* –

(A) Nonresident Alien Engaged in Trade or Business Within the Philippines –

(1) *In General.* – A nonresident alien individual engaged in trade or business in the Philippines shall be subject to an income tax in the same manner as an individual citizen and a resident alien individual, on taxable income received from all sources within the Philippines. A nonresident alien individual who shall come to the Philippines and stay therein for an aggregate period of more than one hundred eighty (180) days during any calendar year shall be deemed a 'nonresident alien doing business in the Philippines.' Section 22(G) of this Code notwithstanding.

(2) *Cash and/or Property Dividends from a Domestic Corporation or Joint Stock Company, or Insurance or Mutual Fund Company or Regional Operating Headquarter of Multinational Company, or Share in the Distributable Net Income of a Partnership (Except a General Professional Partnership), Joint Venture Taxable as a Corporation or Association, <u>Interests</u>, Royalties, Prizes, and other Winnings.* - Cash and/or property dividends from a domestic corporation, or from a joint stock company, or from an insurance or mutual fund company or from a regional operating headquarter of multinational company, or the share of a nonresident alien individual in the distributable net income after tax of a partnership (except a general professional partnership) of which he is a partner, or the share of a nonresident alien individual in the net income after tax of an association, a joint account, or a joint venture taxable as a corporation of which he is a member or a co-owner; <u>*interests*</u>; royalties (in any form); and prizes (except prizes amounting to Ten thousand pesos [P10,000] or less which shall be subject to tax under Subsection

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> [B][1] of section 24); and other winnings (except Philippine Charity Sweepstakes and Lotto winnings), shall be subject to an income tax of twenty percent (20%) on the total amount thereof: *Provided, however*, That cinematographic films and similar works shall be subject to the tax provided under Section 28 of this Code: *Provided, furthermore*, That interest income from long-term deposit or investment in the form of savings, common or individual trust funds, deposit substitutes, investment management accounts and other investments evidenced by certificates in such form prescribed by the Bangko Sentral ng Pilipinas (BSP) shall be exempt from the tax imposed under this Subsection: *Provided, finally*, That should the holder of the certificate pre-terminate the deposit or investment before the fifth (5th) year, a final tax shall be imposed on the entire income and shall be deducted and withheld by the depository bank from the proceeds of the long-term deposit or investment certificate based on the remaining maturity thereof: xxx

However, Section 25(B) of the 1997 Tax Code taxes nonresident alien individuals not engaged in trade or business within the Philippines on their interest realized from Philippine sources. For easy reference, pertinent portions of Section 25(B) of the 1997 Tax Code is hereby quoted as follows:

> SEC. 25. *Tax on Nonresident Alien Individual.* –
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> x x x
>
> (B) *Nonresident Alien Individual Not Engaged in Trade or Business Within the Philippines.* – There shall be levied, collected and paid for each taxable year upon the entire income received from all sources within the Philippines by every nonresident alien individual not engaged in trade or business within the Philippines as interest x x x, or other fixed or determinable annual or periodic or casual gains, profits, and income, and capital gains, a tax equal to twenty-five (25%) of such income. x x x

It should be noted that both Sections 24(B)(1) and 25(A)(2) of the 1997 Tax Code expressly exempt interest derived from certain long-term deposit or investment (covered by Bangko Sentral ng Pilipinas (BSP) certificates and with maturity of five years or more) by citizens, resident aliens and nonresident aliens engaged in trade or business within the Philippines from income tax. However, as in the case of nonresident alien

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individuals not engaged in trade or business in the Philippines, there is no similar exemption from income tax on such interest for corporations, domestic or foreign, under Sections 27 and 28 of the 1997 Tax Code, to wit.

SEC. 27. *Rates of Income Tax on Domestic Corporations.* –

(A) *In General.* – Except as otherwise provided in this Code, an income tax of thirty-five percent (35%) is hereby imposed upon the taxable income derived during each taxable year from all sources within and without the Philippines by every corporation, as defined in Section 22(B) of this Code and taxable under this Title as a corporation, organized in, or existing under the laws of the Philippines: *Provided,* That effective January 1, 1998, the rate of income tax shall be thirty-four percent (34%); effective January 1, 1999, the rate shall be thirty-three percent (33%); and effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%).

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(D) *Rates of Tax on Certain Passive Incomes.* -

(1) *Interest from Deposits and Yield or any Monetary Benefit from Deposit Substitutes and from Trust Funds and Similar Arrangements, and Royalties.* – <u>A final tax at the rate of twenty percent (20%) is hereby imposed upon the amount of interest on currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements</u> received by domestic corporations, and royalties, derived from sources within the Philippines: *Provided, however,* That interest income derived from a depository bank under the expanded foreign currency deposit system shall be subject to a final income tax at the rate of seven and one-half percent (7%) of such interest income.

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SEC. 28. *Rates of Income Tax on Foreign Corporations.* –

(A) *Tax on Resident Foreign Corporations.* –

(1) *In General.* – Except as otherwise provided in this Code, a corporation organized, authorized, or existing under the laws of any foreign country, engaged in trade or business within the Philippines,

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shall be subject to an income tax equivalent to thirty-five percent (35%) of the taxable income derived in the preceding taxable year from all sources within the Philippines: xxx

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(7) *Tax on Certain Incomes Received by a Resident Foreign Corporation.* –

(a) *Interest from Deposits and Yield or any other Monetary Benefit from Deposit Substitutes, Trust Funds and Similar Arrangements and Royalties.* – Interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements and royalties derived from sources within the Philippines shall be subject to a final income tax at the rate of twenty percent (20%) of such interest: *Provided, however*, That interest income derived by a resident foreign corporation from a depository bank under the expanded foreign currency deposit system shall be subject to a final income tax at the rate of seven and one-half percent (7½%) of such interest income.

(B) *Tax on Nonresident Foreign Corporation.* –

(1) *In General.* – Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five percent (35%) of the gross income received during each taxable year from all sources within the Philippines, such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains subject to tax under subparagraphs 5(c) and (d): *Provided*, That effective January 1, 1998, the rate of income tax be thirty-four percent (34%); effective January 1, 1999, the rate shall be thirty-three (33%); and, effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%)

xxx xxx xxx
(*Underscoring supplied*)

Under Section 28(A) of the 1997 Tax Code, resident foreign corporations are subject to the same tax imposed on interest income realized from Philippine sources as domestic corporations. On the other hand, under Section 28(B) of the 1997 Tax Code, nonresident foreign corporations are

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generally subject to 32% tax based on gross income, including interest, effective January 1, 2000. However, on interest income derived from foreign loans contracted on or after August 1, 1986, a final withholding tax rate of 20% is imposed pursuant to Section 28(B)(5)(a) of the 1997 Tax Code.

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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 1997 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 1997 Tax Code. If this is not so, then there will be no need to specifically exempt interest under the provisions of Sections 24(B)(1) and 25(A) because Section 32 pertains to exclusions from gross income which generally applies to all persons subject to income tax, whether individual or corporate.

As previously noted, only citizens, resident aliens and nonresident aliens engaged in trade or business are exempt from income tax on interest from long-term (with a maturity of five years or more) deposit or investment in the form of savings, common or individual trust funds, deposit substitutes, investment management accounts and other investments evidenced by certificates in such form prescribed by the Bangko Sentral ng Pilipinas (BSP) pursuant to Sections 24(B)(1) and 25(A)(2) of the 1997 Tax Code. On the other hand, domestic and resident foreign corporations are subject to a 20% final tax on such interest pursuant to Sections 27(D)(1) and 28(A) of the 1997 Tax Code.

We believe that if Congress intended to exempt *interest* from bonds, debentures and other certificates of indebtedness under Section 32 (B)(7)(g) of the Tax Code, it would have done so in clear and specific terms. The fact that it used the term "Gains from sale" in the aforementioned section, knowing fully well of the reference to interest under Sections 24, 25 27 and 28 of the Tax Code shows that id did not intend to exempt such interest under the aforementioned Section 32 (B)(7) (g) of the Tax Code.

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Parenthetically, in the United States, where it is the interest on certain state and local bonds that is exempt whereas gain from the sale thereof is taxable, there is a clear distinction between interest and gain from sale. Hence, Section 8.07 of Mertens, Law of Federal Income Taxation, provides in pertinent part:

> 8.07 Interest.
>
> The interest exclusion on state and local bonds is limited to interest income relating to tax-exempt bonds. It does not include gain on the sale or exchange of obligations.
>
> Discount
>
> The word "interest" in the Code included "discount." When state or municipal securities are issued at a discount, amounts representing the discount received by the holder either upon the redemption of sale of the securities are tax exempt as being equivalent to interest. As between successive holders of tax-exempt is apportioned on the basis of the time each of the holders held the bond. The remainder of the proceeds is treated as the amount realized on the redemption or sale for purpose of determining gain or loss.
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> Market Discount
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> When the dealer resells bonds at a discount which purchased at par or above, the discount is commonly referred to as "market" discount in contrast to the "issue" discount. If the bonds are capital assets in the hands of the purchaser from the dealer, then the market discount when subsequently realized would give rise to a capital gain. Certain insurance companies, however would be required to accrue this market discount each taxable year as investment income and would adjust the basis of the bonds were held to maturity.
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> The distinction must be noted between accrued interest and discount received upon redemption of state or local obligations prior to maturity and any premium paid on such redemption. It has been ruled that while the accrued interest and discount constitute interest and are, thus, tax-exempt, any premium received upon redemption is taxable income. *(Mertens, The Law of Federal Income Taxation, Section 8.07, Vol. !, Chap 8, pp. 22-24).* (Underscoring supplied)

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From the above discussion, 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. Since the present appeal involves a claim for refund of 20% final withholding tax on interest income earned from long-term investment in FXTNs, the same has no basis in law.

After finding that the interest income derived from FXTNs is not exempt from the 20% final tax, we find it unnecessary to dwell on the rest of the issues raised.

WHEREFORE, in the light of all the foregoing, the instant Petition for Review in hereby **DENIED** for lack of merit.

SO ORDERED.

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

I CONCUR:

ERNESTO D. ACOSTA
Presiding 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

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