REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

TOKIO MARINE MALAYAN INSURANCE COMPANY, INC. (formerly Pan Malayan Insurance Corporation),
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 6472

Promulgated:

DEC 01 2003

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DECISION

This case involves a claim for refund or issuance of a tax credit certificate in the amount of Three Million Eight Hundred Fifty Two Thousand Nine Hundred Pesos (Php 3,852,900.00) allegedly representing interest income derived by petitioner from its investments in long term Fixed Rate Treasury Notes from April 29, 2000 to November 29, 2001.

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 (par. 1, Admitted Facts).

In 1996, 1998 and 1999, petitioner allegedly purchased Fixed Rate Treasury Notes (FXTN) issued by the Bureau of Treasury with the following details:

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Treasury Note	ISIN #	Issue Date	Maturity Date	Principal	Interest Rate	Semi-Annual Interest Payment
FXTN 7-1	PIBD 0703A011	25 Jan 96	25 Jan 03	P 5,000,000	15.500%	P 387,500
FXTN 7-5	PIBD0703G051	25 Jul 96	25 Jul 03	9,000,000	15.750%	708,750
FXTN 10-4	PIBD1007K042	27Nov97	27Nov07	6,000,000	22.875%	686,250
FXTN 7-10	PIBD0705D102	30Apr98	30Apr05	9,700,000	20.500%	994,250
FXTN 7-12	PIBD0705J124	29Oct98	29Oct05	24,000,000	18.375%	2,205,000
FXTN 10-7	PIBD1008K077	26Nov98	26Nov 09	2,500,000	18.000%	225,000

For the period covering April 29, 2000 to November 29, 2001, the Bureau of Treasury paid interest, and withheld tax in the aggregate amount of Php 3,852,900.00, broken down as follows:

Treasury Note ISIN	Interest Payment Date	Total Interest Payable	*20%* Withholding Tax	Net Amount Paid to Malayan
PIBD0703Aoll	26 Jul 00	P387,500	P 77,500	P 310,000
PIBD0703Aoll	26 Jul 01	P387,500	P 77,500	P 310,000
PIBD0703G051	26 Jul 00	P 708,750	P 141,750	P 567,000
PIBD0703G051	26 Jul 00	P 708,750	P 141,750	P 567,000
PIBD1007K042	27 May 00	P 686,250	P 137,250	P 549,000
PIBD1007K042	29 Nov 00	P 686,250	P 137,250	P 549,000
PIBD1007K042	27 May 01	P 686,250	P 137,250	P 549,000
PIBD1007K042	29 Nov 01	P 686,250	P 137,250	P 549,000
PIBD0705D102	30 Apr 00	P 994,250	P 198,850	P 795,400
PIBD0705D102	3 Nov 00	P 994,250	P 198,850	P 795,400
PIBD0705D102	30 Apr 01	P 994,250	P 198,850	P 795,400
PIBD0705D102	3 Nov 01	P 994,250	P 198,850	P 795,400
PIBD0705J124	29 Apr 00	P 2,205,000	P 441,000	P 1,764,000
PIBD0705J124	29 Oct 00	P 2,205,000	P 441,000	P 1,764,000
PIBD0705J124	29 Apr 01	P 2,205,000	P 441,000	P 1,764,000
PIBD0705J124	29 Oct 01	P 2,205,000	P 441,000	P 1,764,000
PIBD1008K077	26 Nov 00	P 765,000	P 153,000	P 612,000
PIBD 1008K077	26 Nov 01	P 765,000	P 153,000	P 612,000
	TOTAL WITHHOLDING TAX		P 3,852,900	

Claiming that the Bureau of Treasury erred in applying the 20% withholding tax on the interest income realized from such treasury notes considering that the said notes have a maturity of more than five years, petitioner, on April 29, 2002, requested for a refund or a tax credit of the amount of Three Million Eight Hundred Fifty Two Thousand Nine Hundred Pesos (Php 3,852,900.00) alleged to have been erroneously withheld from its interest income on long-term FXTNs from April 29, 2000 to November 29, 2001. To suspend the running of the two-year prescriptive period provided for under Section 229 of the Tax Code, petitioner filed the instant Petition for Review on the same day.

Respondent, in his Answer filed on May 30, 2002, prayed for the dismissal of the case and raised the following Special and Affirmative Defenses:

> "4. Interest income is not gain from the sale or exchange or retirement of bonds, debentures or other certificates of indebtedness with a maturity of more than 5 years, hence, subject to income tax (*Nippon Life Insurance Co. of the Phils., Inc. vs. CIR, CTA Case No. 6142, February 4, 2002)*;
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> 5. Petitioner's alleged claim for refund is subject to administrative routinary investigation by the BIR;
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> 6. Petitioner miserably failed to demonstrate that the taxes subject of the case at bar were erroneously or illegally collected;
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> 7. The amount of P3,852,900.00 being claimed by petitioner as alleged erroneous withholding of tax on interest payments was not properly documented.
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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. In an action for refund the burden of proof is on the taxpayer to establish its right to refund, and failure to sustain the burden is fatal to the claim for refund/credit;

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10. It is incumbent upon petitioner to show that it has complied with the provisions of Sections 204 (c) and 229 of the Tax Code on the prescriptive period for claiming tax refund/credit;

11. Well-settled is the rule that claims for tax refund/credit are construed in *strictissimi juris* against the taxpayer as they partake the nature of exemption from tax, and it is incumbent upon the petitioner to show that it is entitled thereto under the law."

As contained in the Joint Stipulation of Facts and Issues filed by the parties on August 1, 2002 and approved by this court on August 2, 2002, the issues to be resolved in this case are:

1. Whether or not interest income derived from treasury notes which have a maturity in excess of five (5) years is exempt from the 20% withholding tax;

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

3. Whether or not the Bureau of Treasury paid interest on the treasury notes and withheld tax at the rate of 20% of the interest payment in the amount of P3,852,900.00; and

4. Whether or not petitioner is entitled to a refund/tax credit on the amount withheld on such interest payment amounting to P3,852,900.00.

On the first issue, petitioner claimed that the interest income it derived from its investments in long-term treasury notes is exempt from income tax under Section 32(B)(7)(g) of the 1997 National Internal Revenue Code, to wit:

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SEC. 32. ***Gross Income. –***

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(B) *Exclusions from Gross Income.* – The following items shall not be included in gross income and shall be exempt from taxation under this Title:

xxx xxx xxx

(7) *Miscellaneous Items.* –

xxx xxx xxx

(g) *Gains from the Sale of Bonds, Debentures or other Certificate of Indebtedness.* – 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.

And to further support its position that the interest income derived from its investments is exempt from tax, petitioner cited respondent's own rulings, namely, BIR Ruling No. 166-99 dated October 25, 1999, BIR Ruling No. 016-2000 dated January 7, 2000 and BIR Ruling DA-022-01-11-00.

In BIR Ruling No. 166-99, addressed to Aegon Life Insurance (Philippines), Inc., respondent ruled that interest income or yields or gain from the sale of bonds, debentures and certificates of indebtedness with maturities of more than five (5) years are excluded from gross income in accordance with Section 32(B)(7)(g) of the 1997 Tax Code and therefore exempt from the 20% final withholding tax on deposit substitutes. The said ruling states in pertinent part:

"B. 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 1997 Tax Code.

However, Section 32(B)(7)(g) of the 1997 Tax Code, provides an exception, thus:

"Section 32. Gross Income. —

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"(B) Exclusions from Gross Income. — The following items shall not be included in gross income and shall be exempt from taxation under this Title:

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"(7) Miscellaneous Items. —

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"(g) Gains from the Sale of Bonds, Debentures or other Certificate of Indebtedness. 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."

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.

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. 1917F, 806." (Words & Phrases, Gain, page 11, Permanent Edition 18) (BIR Ruling No. 166-99)

BIR Ruling No. 016-2000, dated January 7, 2000, confirmed its previous interpretation of Section 32(B)(7)(g) and stated that:

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> "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 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 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."

Then, in BIR Ruling DA-022-01-11-00, the respondent ruled that "(s)ince the maturity period of the above-mentioned asset-backed bond issue will be more than five (5) years, **the gains which would include interest or yield and any other income** derived from the sale (including origination, issuance, or flotation), exchange or retirement of the bonds that may be derived therefrom shall accordingly be exempt from income tax. Likewise, not being in the nature of 'Deposit Substitute Instruments' as this term is defined in the Code and as further described in Rev. Regs. 17-84, the gains accruing from these long-term asset-backed bonds are also exempt from the 20% final withholding tax."

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, dated February 4, 2002,*** this court first passed upon the issue, thus:

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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:

> "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 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

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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;
(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",

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> 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.
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> 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) of the 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 Tax Code.
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> 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 full well of the reference to interest under Sections 24, 25, 27 and 28 of the Tax Code shows that it did not intend to exempt such interest under the aforementioned Section 32(B)(7)(g) of the Tax Code."

The above pronouncement was reiterated in the cases of ***Malayan Reinsurance Corporation (formerly Eastern General Reinsurance Corporation) vs. Commissioner of Internal Revenue, CTA Case No. 6252, July 24, 2002; Resolution dated November 19, 2002; Malayan Zurich Insurance Company, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6251, September 30, 2002; First Nationwide Assurance Corporation vs. Commissioner of Internal Revenue, CTA Case No. 6253, October 3, 2002; Rizal Commercial Banking Corporation vs. Commissioner of Internal Revenue, CTA Case No. 6228, December 4, 2002; Malayan Insurance Company, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6243, December 16, 2002; Tokio Marine Malayan Insurance Co, Inc., (formerly***

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Pan Malayan Insurance Corp.) vs. Commissioner of Internal Revenue, CTA Case No. 6254, January 13, 2003; RCBC Savings Bank, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6341, May 5, 2003; Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6323, July 24, 2003; Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6348, September 12, 2003; and Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6289, September 22, 2003.

Significantly, our ruling in CTA Case No. 6142 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,*** where it was held:

> "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

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is impossible not to see that the law did qualify such term and restricted it to gains from sale of bonds.

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.

Nippon's position must have drawn inspiration from the tax exemption of long-term deposits under Section 24(B)(1) and (25)(A)(2) of the Tax Reform Act. However, these provisions fall under Chapter III, entitled Tax on Individuals and cover specifically citizens/resident aliens and non-resident aliens, respectively. On the other hand, Chapter IV, the Tax on Corporations, does not contain a similar exemption on long-term deposits held by corporations, such as Nippon. Thus, the CTA correctly concluded that interests income on bonds held by corporations are not tax exempt, unlike those held by individuals. This is the law but Nippon could not abide by this and so it attempted to make up for this deficiency in Chapter IV by enlarging the scope of Section 32(B)(7)(g). For these unassailable reasons, the petition must fail."

It is clear from the foregoing discussion that the tax exemption from final withholding tax granted under Section 32(B)(7)(g) of the Tax Code is limited only to the gain from sale of long-term investments (as distinguished from interest income earned from long-term investments which are subject to the 20% final withholding tax). Since the present case involves a claim for refund of 20% final withholding tax on interest income earned from investment in long term FXTNs, the same has no basis in law.

At this point, the oft-repeated principle that 'tax refunds are in the nature of tax exemptions, and as such they are regarded as in derogation of sovereign authority and to be construed *strictissimi juris* against the person or entity claiming the exemption' deserves reiteration ***(Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc., 309 SCRA 87; and Commissioner of Customs v. Court of Tax Appeals, 328 SCRA 822)***.

The legal issue having been resolved in the negative, the court finds it no longer necessary to resolve the factual issues raised.

WHEREFORE, the instant petition for review is hereby **DENIED** for lack of merit.

SO ORDERED.

JUANITO C. CASTAÑEDA, JR.
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

LOVELL R. BAUTISTA
Associate Judge

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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