REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

FIRST NATIONWIDE ASSURANCE CORPORATION,
Petitioner,

C.T.A. EB No. 1
(C.T.A. Case No. 6473)

PRESENT:

- versus -

ACOSTA, *P.J.*,
CASTAÑEDA, JR.,
BAUTISTA,
UY,
CASANOVA, and
PALANCA-ENRIQUEZ, *JJ.*

COMMISSIONER OF INTERNAL REVENUE,
Respondent,

Promulgated:

JUN 07 2005 [signature]

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DECISION

CASTAÑEDA, JR., *J.*:

This is a Petition for Review before the Court of Tax Appeals *En Banc* pursuant to Section 18 of Republic Act No. 1125 as amended by Section 11 of Republic Act No. 9282 seeking for the reversal of the Decision promulgated on December 22, 2004 by the then Court of Tax

Appeals in C.T.A. Case No. 6473 entitled "First Nationwide Assurance Corporation v. Commissioner of Internal Revenue and the Resolution dated March 29, 2004 which affirmed the ruling in the Court's Decision the dispositive portion of which reads as follows:

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

The undisputed facts of the case are as follows:

Petitioner is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal offices at Yuchengco Tower, 500 Q. Paredes St., Binondo, Manila.

In 1996, 1998, and 1999, petitioner purchased from Citibank, N.A. and China Banking Corporation (CBC) treasury notes issued by the Bureau of Treasury with the following details:

Value Date	Selling Bank	Exhibit	Type/ Series No.	ISIN No.	Issue Date	Maturity Date	Par/ Face Amount
07-25-96	Citibank	E-1, F-1	FXTN 7-5	PIBDO703G051	07-25-96	07-25-03	4,000,000.00
09-26-96	CBC	E-2, F-2	FXTN 10-1	PIBD10061010	09-26-96	09-26-06	5,000,000.00
02-17-99	Citibank	E-3, F-4	FXTN 10-4	PIBD1007K042	11-27-97	11-27-07	3,000,000.00
07-17-98	Citibank	E-4, F-5	FXTN 7-9	PIBD0704JO92	10-30-97	10-30-04	2,800,000.00

On October 25, 1999, the BIR issued BIR Ruling No. 166-99, providing that the interest income, yield or gain from the sale of bonds, debentures or certificates of indebtedness as deposit substitutes, which are ordinarily subject to 20% final tax under Section 27(D)(1) of the NIRC, should be excluded from the gross income if the bonds, debentures or the certificates of indebtedness have maturities of more than five (5) years.

On January 7, 2000, BIR Ruling No. 016-00 was issued, with the BIR reiterating its stand that "if the maturity period of the bonds issued through the Bureau of Treasury will be more than five (5) years, the gains that may be derived therefrom by the bondholders shall accordingly be exempt from the 20% final withholding tax." The BIR stated further that: "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."

For the period April 30, 2000 to November 29, 2001, petitioner earned interest income from the treasury notes it purchased in the gross amount of P4,371,500.00, which was subjected to 20% final withholding tax by the Bureau of Treasury in the total amount of P874,300.00, broken down as follows:

Treasury Note ISIN	Interest Payment Date	Total Interest Payable	20% Withholding Tax	Net Amount Paid
PIBD0703G051	26-Jul-00	P315,000.00	P63,000.00	P252,000.00
PIBD0703G051	26-Jul-01	P315,000.00	P63,000.00	P252,000.00
PIBD10061010	27-Sep-00	P400,000.00	P80,000.00	P320,000.00
PIBDI0061010	26-Mar-01	P400,000.00	P80,000.00	P320,000.00
PIBD1006I010	27-Sep-01	P400,000.00	P80,000.00	P320,000.00
PIBD0704J092	30-Apr-00	P292,250.00	P58,450.00	P233,800.00
P1BD0704J092	03-Nov-00	P292,250.00	P58,450.00	P233,800.00
PIBD0704J092	30-Apr-01	P292,250.00	P58,450.00	P233,800.00
PIBD0704J092	03-Nov-01	P292,250.00	P58,450.00	P233,800.00
PIBD1007K042	27-May-00	P343,125.00	P68,625.00	P274,500.00
PIBD1007K042	29-Nov-00	P343,125.00	P68,625.00	P274,500.00
PIBDI007K042	27-May-01	P343,125.00	P68,625.00	P274,500.00
PIBD1007K042	29-Nov-01	P343,125.00	P68,625.00	P274,500.00
TOTAL		P4,371,500.00	P874,300.00	P3,497,200.00

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 treasury notes have a maturity of more than five years, petitioner, on April 18, 2002, filed with the Large Taxpayers Assessment Division of the Bureau of Internal Revenue, an administrative claim for refund in the amount of P874,300.00.00.

Petitioner posits that the interest income on its long-term investments constitutes gain from the sale of bonds, debentures and certificates of indebtedness with maturities of more than five (5) years as provided under paragraph 7(g) of Section 32(B) of the Tax Code.

Accordingly, the said interest income is exempt from the 20% withholding tax on deposits and deposit substitutes.

On April 29, 2002, without waiting for an answer from the respondent, petitioner filed its Petition for Review with the then Court of Tax Appeals in order to toll the running of the two-year prescriptive period.

On December 22, 2003, the Court promulgated its Decision denying petitioner's claim for refund, ruling 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.

Petitioner filed a Motion for Reconsideration on February 4, 2004 and argued that the term "gain" as used in Section 32(B)(7)(g) is broad enough to include interest income from fixed rate treasury notes with maturity of more than five (5) years.

On March 29, 2004, the Court promulgated its Resolution on petitioner's Motion for Reconsideration reiterating its previous ruling that the term "gains" as used 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.

Hence, petitioner filed a Petition for Review with the Court *En Banc* based on a lone assignment of error:

> **WHETHER OR NOT THE CTA DIVISION ERRED IN RULING THAT THE TERM "GAIN" AS USED IN SECTION 32 (B) (7) (g) OF THE TAX CODE DOES NOT INCLUDE INTEREST.**

ARGUMENTS

According to the petitioner, the word gain includes interest income and argues that:

> "The term gain is very broad in scope that it includes interest income. A gain means increase or addition to what one has of that which is of profit, advantage, or benefit; resources or advantage acquired, profit; opposed to loss; act of gaining something; specially, the obtaining or amassing or profit or valuable possession; acquisition; accumulation.
>
> The term gain has also been defined as profits; winnings; increment of value.
>
> However, the CTA Division would rather carve out an exception to this rule by ruling 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 the sale of long-term investments (as distinguished from interest income earned from long-term investments which are subject to the 20% final withholding tax). Petitioner submits that the CTA Division's interpretation of the said section runs counter to the law and legislative intent."

The petitioner proffers the following arguments in support of its position:

a) **The Legislative intent is to encourage investments in long-term bonds.** – in enacting Republic Act 8424, otherwise known as the Comprehensive Tax Reform Act, Congress saw it fit to provide for a new exclusion to gross income subject to income tax. This new exclusion is contained in Section 32 (B) (7) (g) of the 1997 Tax Code, to wit:

> Sec. 32 (B) *Exclusions from Gross Income* – The following items shall not be included in gross income and shall be exempt from taxation under this Title:
>
> (7) (g) *Gains from 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 years.***

Then Commissioner of Internal Revenue, Beethoven L. Rualo elucidated on the rationale behind this provision in BIR Ruling No. 166-99:

> "this new provision, excluding from gross income the gains from sale, exchange or retirement of bonds, debentures or other certificates of indebtedness with a maturity of more than five (5) years, is meant to give an incentive as an encouragement for investors in long term debt securities and development of a secondary market."

b) **Interest realized as a result of the primary sale of long-term bonds constitute gains derived from the sale of long-term bonds.**- As pointed out above, the tax exemption under Section 32 (B) (7) (g) refers to all "gains" realized from the sale, exchange or retirement of long-term bonds. The "gain" need not be limited to that realized by the seller alone for Section 32 (B) (7) (g) is broad enough to cover gains realized by the buyer as well, particularly in the form of interest income realized by the buyer from the primary sale of the long-term bonds.

c) **CTA Division's decision would result in an absurd situation.** – Following the "logic" of the Decision, a situation would arise wherein interest income derived from a coupon-bearing bond would be subject to income tax, but interest income from zero-coupon bonds would be exempt from income tax.

d) **CTA division's decision would only frustrate the legislative intent.** – If the Decision were to be upheld, investors in long-term securities would be encouraged to sell such long-term securities rather than keep them for the duration of their term. For in selling such securities, the investor would be exempted from tax on the income realized from such secondary sale; as opposed to being subjected to income tax for holding on to the long-term security.

e) **The term "gain" should be understood in a generic and not in the restrictive sense.** – In ruling that the term "gain" does not include "interest", it is apparent that the CTA Division interpreted the term "gain" in its restrictive sense. Such interpretation, aside from deviating from the legislative intent, runs counter to the rules on statutory construction; *i.e.* statutory language should be interpreted in a <u>generic sense</u> and given its usual and commonly understood meaning.

f) **Exemption of interest under Section 24(B)(1) and 25(A) does not preclude exemption under Section 32 (B)(7)(g).** – In its Reply filed on January 12, 2005, petitioner argues that respondent in his Comment, is suggesting that, since Sections 24(B)(1) and (25)(A) already deal with the tax exemption of interest income, Section 32(B)(7)(g) necessarily excludes from its provisions any further exemptions of interest income. Again, it is respectfully submitted that such logic is flawed. Considering that these three provisions provide for exemptions from distinct sources of interest income, that nowhere in the provisions of Section 24(B)(1) and Section 25(A) is it categorically stated that such sections shall be deemed to be an exclusive enumeration of income exempt from taxation, and that there is no statute, ruling, memorandum or jurisprudence providing for such exclusivity, petitioner submits that the exemption of interest income under Section 24(B)(1) and 25(A) does not preclude exemption under Section 32(B)(7)(g).

On the other hand, the respondent filed his Comment on December 20, 2004 asserting that although a ruling issued by the Commissioner of Internal Revenue commands respect and weight, the same is not conclusive upon the courts and will be ignored if found to be erroneous and Sections 24(B)(1) and 25(A)(2) of the Tax Code, as amended, both expressly exempt from income tax interest derived from certain long-term deposits or investments (covered by Bangko Sentral ng Filipinas certificates with maturity of five years or more) by citizens, resident aliens and non-resident aliens engaged in trade or business within the Philippines. However, there is no such exemption from income tax on such interest for corporations, domestic or foreign under Sections 27 and 28 of the 1997 Tax Code. Lastly, it is a 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.

The issue presented before the Court *En Banc* had already been resolved by the Supreme Court in the case of ***NIPPON LIFE INSURANCE COMPANY OF THE PHILIPPINES, INC., vs. COMMISSIONER OF INTERNAL REVENUE, G.R. No. 159612, NOVEMBER 19, 2003.*** The High Court denied the Petition for Review of the Decision of the Court of Appeals in CA-G.R. SP No. 69224 through a Resolution of its Third Division reading as follows:

> "G.R. No. 159612 (Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue) – Acting on the petition for review on certiorari of the decision dated November 15, 2002 of the Court of Appeals in CA-G.R. SP No. 69224, the Court Resolved to ***DENY*** the petition for failure of petitioner to show that a reversible error had been committed by the appellate court."

In CA-G.R. SP No. 69224 entitled Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue, the Court of Appeals affirmed the Decision of the then Court of Tax Appeals in C.T.A. Case No. 6142 dated February 4, 2004 and We quote hereunder a portion of the Court of Appeals' decision:

> "The point of contention here is the interpretation of the term "gains" in Section 32(B)(7)(g) of the Tax Reform Act of 1997, which excludes gains from the sale, exchange or retirement of bonds from the computation of gross income. If so excluded, no taxes are due on such transactions. Petitioner Nippon and the BIR, through then Commissioner Beethoven L. Rualo, take the view that gains encompass interest income from bonds, thereby entitling Nippon to a refund of taxes paid on interest income received from the subject bond. Nippon supports its view with the legislative intent behind the Tax Reform Act to grant incentives to develop the bond market. Furthermore, Nippon insists that the law does not qualify the term "gains" and so the CTA erred in distinguishing "gains" from "interests" into separate categories.
>
> The CTA, on the other hand, ruled that "gains", as used in Section 32(B)(7)(g) refers only to those emanating from the sale of bonds, thereby, excluding "interests" in the process. It stressed the distinction between "gains derived from dealings in property" and "interests", which are classified as separate items of gross income. From this distinction, the CTA went on to conclude that only interests on long-term bonds held by individuals, whether citizens, resident aliens or non-resident aliens are tax-exempt. The interests on such bonds held by corporations, domestic or otherwise, are neither excluded from gross income nor exempt from taxes.

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 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.

First, while the Tax Reform Act adhered to the above definition or 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 the 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 the sale of bonds.**" (Emphasis supplied)

Petitioner's assertion that interest income is included in the term "gain" under Section 32(B)(7)(g) is untenable. The distinction between interest and gain from sale of bonds has been explained by the then Court of Tax Appeals in the aforementioned case of Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue, C.T.A. Case No. 6142, February 4, 2002, by quoting the discussion in Section 8.07 of Mertens, *The Law of Federal Income Taxation* on a diametrically opposed provision on State bonds in the Internal Revenue Code of the United States, as follows:

"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".

In Section 8.10 thereof, Mertens explained that the "[G]ain from the sale of State or municipal obligations is taxable. **Such amounts are not interest**. Where a bond is issued at a discount and redeemed at par, the amount of the discount is interest. Where the interest coupons were detached from the municipal bonds, and the bonds and coupons sold separately, the amount received on the sale of the coupons (in excess of the interest accrued at the time of the sale) has been held not to be tax-exempt interest; the gain on the sale of both the bonds and the coupons (in excess of accrued interest) was treated as a taxable gain on the sale of property." (Emphasis supplied; citations omitted) The foregoing plainly establishes the distinction between interest income from bonds and gain on sale of bonds. Indeed, each item of income can be treated separately from the other. They are not the same, hence, their taxability under the NIRC of 1997 are likewise different from each other.

To this Court's mind, even under this restrictive interpretation of gains, the legislative intent to encourage investment in long-term bonds is still subserved, as gains from the sales of long-term bonds, debentures or certificate of indebtedness with a maturity of more than five (5) years, are excluded from the computation of gross income (UNIVERSAL MALAYAN REINSURANCE CORPORATION [formerly Malayan Reinsurance

Corporation] vs. COMMISSIONER OF INTERNAL REVENUE, C.T.A. EB NO. 6, MARCH 28, 2005).

WHEREFORE, the Court *En Banc* finds no reversible error in the Decision promulgated on December 22, 2003 and Resolution dated March 29, 2004. Accordingly, the Petition for Review is hereby **DENIED** for lack of merit and the aforementioned Decision and Resolution are hereby **AFFIRMED** *in toto*.

SO ORDERED.

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

We Concur:

(on leave)
ERNESTO D. ACOSTA
Presiding Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

(on leave)
OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

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

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