REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MALAYAN INSURANCE CO., INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 6243

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
DEC 16 2002 [signature]

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DECISION

This case involves a claim for refund or issuance of a tax credit certificate in the amount of P5,312,545.00, allegedly representing erroneously withheld 20% final tax on interest income derived by petitioner from investments on fixed rate treasury notes (FXTN's for brevity) with a maturity of more than five (5) years during the taxable year 1999.

Petitioner is a corporation organized and existing under and by virtue of the laws of the Philippines, with principal office located at Yuchengco Tower, 500 Q. Paredes Street, Binondo, Manila (*par. 1, Joint Stipulation of Facts and Issues*).

From 1996 to 1999, petitioner purchased long-term FXTN's from the Bureau of Treasury, detailed as follows:

Treasury Note	ISIN #	Issue Date	Maturity Date	Principal	Interest Rate	Semi-annual Interest Payment
FXTN7-2	PIBD0703R029	29 Feb 96	29 Feb 03	P6,000,000	15.375%	P461,250
FXTN7-1	PIBD0703A011	25 Jan 96	25 Jan 03	5,000,000	15.500%	387,500
FXTN7-4	PIBD0703E044	30 May 96	30 May 03	4,860,000	15.375%	373,612.50
FXTN7-5	PIBD0703G051	25 Jul 96	25 Jul 03	5,000,000	15.750%	393,750

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FXTN10-1	PIBD1006I010	26 Sep 96	26 Sep 06	15,000,000	16.000%	1,200,000
FXTN10-4	PIBD1007K042	27 Nov 97	27 Nov 07	17,800,000	22.875%	2,035,875
FXTN10-7	PIBD1008KT29	26 Nov 98	26 Nov 08	19,000,000	17.800%	1,691,000
FXTN7-10	PIBD0705D102	30 Apr 98	30 Apr 05	23,200,000	20.500%	2,378,000
FXTN7-12	PIBD0705J124	29 Oct 98	29 Oct 05	32,800,000	18.375%	3,013,500
FXTN10-8	PIBD1009B084	25 Feb 99	25 Feb 09	30,000,000	16.500%	2,475,000
FXTN7-11	PIBD0705G118	30 Jul 98	30 Jul 05	10,000,000	20.000%	1,000,000

For the months of February to December 1999, the Bureau of Treasury paid interest on the said treasury notes for which the corresponding 20% final tax in the aggregate amount of P5,312,545.00 was withheld, details of which are shown below:

Treasury Note	Interest Payment Date	Total Interest Payable	20% Withholding Tax	Net Amount Paid to Malayan
FXTN7-2	28 Feb 99	P 461,250	P 92,250	P 369,000
	28 Aug 99	461,250	92,250	369,000
FXTN7-1	25 Jul 99	387,500	77,500	310,000
FXTN7-4	30 May 99	373,612.50	74,722.50	298,890
	30 Nov 99	373,612.50	74,722.50	298,890
FXTN7-5	25 Jul 99	393,750	78,750	315,000
FXTN10-1	26 Mar 99	1,200,000	240,000	960,000
	26 Sep 99	1,200,000	240,000	960,000
FXTN10-4	27 May 99	2,035,875	407,175	1,628,700
	29 Nov 99	2,035,875	407,175	1,628,700
FXTN10-7	26 May 99	1,691,000	338,200	1,352,800
	26 Nov 99	1,691,000	338,200	1,352,800
FXTN7-10	30 Apr 99	2,378,000	475,600	1,902,400
	30 Oct 99	2,378,000	475,600	1,902,400
FXTN7-12	29 Apr 99	3,013,500	602,700	2,410,800
	29 Oct 99	3,013,500	602,700	2,410,800
FXTN10-8	25 Aug 99	2,475,000	495,000	1,980,000
FXTN7-11	30 Jul 99	1,000,000	200,000	800,000
		Total Withholding Tax	P5,312,545.00	

On October 25, 1999, the BIR issued BIR Ruling No. 166-99 stating that the interest income, yield or gain derived from 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.

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On the strength of the aforementioned ruling and citing Section 32 (B)(7)(g) of the National Internal Revenue Code of 1997 which 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 taxable income, petitioner wrote a letter on February 27, 2001 addressed to the respondent requesting that a refund or a tax credit in the amount of Five Million Four Hundred Sixty-Eight Thousand Seven Hundred Ninety-Five Pesos (P5,468,795.00), which included the Five Million Three Hundred Twelve Thousand Five Hundred Forty-Five Pesos (P5,312,545.00) corresponding to the tax withheld by the Bureau of Treasury on the said treasury notes, be issued by the respondent in favor of petitioner.

On the following day, February 28, 2001, petitioner filed the instant petition for review to toll the running of the two-year prescriptive period.

In his answer filed on April 4, 2001, respondent raised the following Special and Affirmative Defenses, thus:

> "6. Petitioner's claim for refund is still subject to administrative investigation/examination before the Bureau.
>
> 7. Petitioner's (sic) failed to prove that the tax subject of the case at bar comes within the scope of claims for refund pursuant to section 204 of the National Internal Revenue Code. The said section of the Tax Code explicitly enumerates the grounds upon which a taxpayer is allowed to claim for refund, to wit: (a) erroneously or illegally received or collected internal revenue taxes; (b) penalties imposed without authority. The above-mentioned grounds are exclusive.
>
> 8. Claims for refund are construed strictly against the claimant as they partake the nature of an exemption from tax and it is incumbent upon petitioner to prove that it is entitled thereto under the law. Failure to prove the same is fatal to its claim for tax refund. Exemptions from taxation are highly disfavored in law and he who claims exemption must be able to justify his claim by

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the clearest grant of organic or statutory law. An exemption from common burden can not be permitted to exist upon the vague implications. (*Asiatic Petroleum Co. vs. Llamas 49 Phil 466*).

9. Moreso, 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 209 of the National Internal Revenue Code.

10. Finally, following the well entrenched principle that tax refunds are in the nature of tax exemptions, they are regarded as derogation of sovereign authority and are to be construed in *stricssimi juris* against the person or entity claiming the exemption."

The following issues have been jointly stipulated by the parties, to wit:

1. Whether or not interest income derived from treasury notes which have a maturity in excess of five years is exempt from the 20% withholding tax.
2. Whether or not the treasury notes purchased by petitioner from the Bureau of Treasury can be considered as bonds, debentures or certificates of indebtedness under the Tax Code.
3. Whether or not the claim for refund/tax credit of petitioner in the amount of P5,312,545 is properly substantiated by documentary evidence.

The resolution of the legal issue centers on the proper interpretation of the term "gains" as used in Section 32(B)(7)(g) of the Tax Code of 1997. Under the said section, gains realized from the sale or exchange or retirement of bonds, debentures or other certificates of indebtedness with a maturity of more than five (5) years shall not be included in gross income and shall be exempt from taxation. Petitioner interpreted the

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word "gains" in Section 32(B)(7)(g) as broad enough to include interest income from FXTNs.

In BIR Ruling No. 166-99, issued on October 25, 1999 and 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. Pertinent portion of BIR Ruling No. 166-99 is hereby quoted as follows:

> "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.
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> However, Section 32(B)(7)(g) of the 1997 Tax code, provides an exception, thus:
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> "Section 32. Gross Income. –
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> xxx xxx xxx
>
> "(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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> 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."

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> 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 nor 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. 191F, 806." (Words & Phrases, Gain, page 11, Permanent Edition 18) (BIR Ruling No. 166-99)

Notwithstanding the abovementioned rulings, we cannot agree with petitioner's contention that interest income on its long-term investments in FXTNs should be considered as 'gains' exempt from income tax pursuant to Section 32(B)(7)(g) of the 1997 Tax Code.

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. ***(Philippine Bank of Communications vs. Commissioner of Internal Revenue, G.R. No. 112024, January 28, 1999)***.

In the present 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 1997 Tax Code include interest. ***(Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6142, February 4, 2002)***

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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 1997 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 1997 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 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 certificate of indebtedness with a maturity of more than five (5) years" in its body. Stated otherwise, Section 32(B)(7)(g) of the 1997 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 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;

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(3) Gains derived from dealings in property;
(4) Interests;
(5) Rents;
(6) Royalties;
(7) Dividends;
(8) Annuities;
(9) Prizes and winnings;
(10) Pensions; and
(11) Partner's distributive share from the net income of the general professional partnership.

From the aforequoted Section 32(A) of the 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.

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;

(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 interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust fund and similar arrangements; 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 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: *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%

xxx xxx xxx

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 notwitstanding.

(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, **Interests**, 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; *interests*; 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 [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 Sectin 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 investmtnes evdienced by certificates in such form prescribed by the Bangko Sentral ng Pilipinas (BSP) shall be exempt from the tax imposed under this Subsetion: *Provided, finally*, That should the holder of the certficate pre-terminate the deposit or investment before the fifth (5th) year, a final tax shall b imposed on the entire income and shall be deducted and withheld by the depository bank from the proceeds of the long-term deposit or investmtne 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

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more) by citizens, resident aliens and nonresident aliens engaged in trade or business within the Philippines from income tax. However, like in the case of nonresident alien 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%).
>
> xxx xxx xxx
>
> (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.
>
> xxx xxx xxx
>
> **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

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foreign country, engaged in trade or business within the Philippines, 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

xxx xxx xxx

(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 sucht 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-halt 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 ', 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 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.

Obviously, from the aforementioned Sections 24, 25, 27 and 28 of the 1997 Tax Code, in relation to Sections 31 and 32 of the same Code, there is no sweeping exemption from income tax of interest income derived from bonds, debentures or other certificates of indebtedness with a maturity of more than five (5) years.

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

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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 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 1997 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 1997 Tax Code shows that it did not intend to exempt such interest under the aforementioned Section 32(B)(7)(g).

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, *The Law Of Federal Income Taxation,* provides in pertinent part:

> **§8.07. Interest.**
>
> The interest exclusion on state and local bonds is <u>limited to interest income relating to tax-exempt bonds</u>. It does <u>not include gain on the sale or exchange of obligations.</u>
>
> Discount
>
> The word "interest" in the Code includes "discount." When state or municipal securities are *issued* at a discount, amounts representing the discount received by the holder either upon the redemption or sale of the securities are tax-exempt as being equivalent to interest. As between

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> successive holders of a tax-exempt municipal bond, the original issue discount which is 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.
>
> Market Discount
>
> When a dealer resells bonds at a discount which he purchased at par or above, that discount is commonly referred to as "market" discount in contrast to "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 also adjust the basis for the bonds so that no gain would be realized upon redemption if the bonds were held to maturity.
>
> The distinction must be noted between accrued interest and discount received upon the 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. 1, Chap. 8, pp. 22-24. (*Underscoring supplied.*)**

Consequently, this court has on several occasions ruled that the tax exemption on long-term gains under Section 32(B)(7)(g) does not include interest (***Nippon Life Insurance Company of the Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6142, February 4, 2002; Malayan 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; and First Nationwide Assurance Corporation vs. Commissioner of Internal Revenue, CTA Case No. 6253, October 3, 2002).***

In fine, only the gain from sale (as distinguished from interest) of bonds, debentures or other certificate of indebtedness with maturity of more than five years shall be exempt from income tax. Corollary, since the present appeal involves 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.

WHEREFORE, in view of all the foregoing, the instant petition for review is 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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