# REPUBLIC OF THE PHILIPPINES
# COURT OF TAX APPEALS
# QUEZON CITY

**RCBC SAVINGS BANK, INC.,**
Petitioner,

- versus -

C.T.A. CASE NO. 6341

**COMMISSIONER OF INTERNAL REVENUE,**
Respondent.

Promulgated:
MAY 05 2003

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## DECISION

This case involves a claim for refund or issuance of tax credit certificate in the amount of P17,230,177.62 allegedly representing erroneously withheld 20% final tax on interest income derived by petitioner from its investments in long term treasury bonds (Bonds, for brevity) from the third quarter of 1999 up to the fourth quarter of 2000.

Petitioner is a corporation duly organized and existing under and by virtue of the laws of the Philippines, with principal office located at the 9th Floor, Y-Tower II Office Condominium, Alfaro corner Gallardo Street, Salcedo Village, Makati City. It is duly registered with the Securities and Exchange Commission and authorized by the Bangko Sentral ng Pilipinas to engage in general banking operations as a thrift bank (*par. 1, Joint Stipulation of Facts and Issues*). In the course of its business operations, petitioner invests in government securities consisting of bonds and other evidences of debt of the Philippine Government, earning interest income therefrom.

From the third quarter of 1999 up to the fourth quarter of 2000, petitioner earned interest income from its long-term treasury coupon bonds issued by the Government of the Philippines in the gross amount of P86,153,888.07, which were subjected to final withholding taxes in the sum of P17,230,177.62, detailed as follows: (*Exhibit B, inclusive of sub-markings*)

| Particulars | 3rd Qtr. 1999 | 4th Qtr. 1999 | 1st Qtr. 2000 | 2nd Qtr. 2000 | 3rd Qtr. 2000 | 4th Qtr. 2000 | Total | Tax Rate | Final With-holding Tax |
|---|---|---|---|---|---|---|---|---|---|
| T/B800505700 | 4,000.00 | | 4,000.00 | | 4,000.00 | | 12,000.00 | 0.15 | 1,800.00 |
| PIID0504F011 | | 172,204.86 | 6,679,656.25 | 7,752,485.34 | 7,752,485.34 | 7,752,485.34 | 30,109,317.13 | 0.20 | 6,021,863.43 |
| PIIBD0504K234 | | | | 15,532,500.00 | | 17,582,718.75 | 33,115,218.75 | 0.20 | 6,623,043.75 |
| PIIBD0504L253 | | | | 1,025,898.75 | | | 1,025,898.75 | 0.20 | 205,179.75 |
| PIBD0505A261 | | | | | 3,781,250.00 | | 3,781,250.00 | 0.20 | 756,250.00 |
| PIBD707A209 | | | | | 5,111,250.00 | | 5,111,250.00 | 0.20 | 1,022,250.00 |
| PIBD1010B153 | | | | | 9,145,000.00 | | 9,145,000.00 | 0.20 | 1,829,000.00 |
| PIBD0505B279 | | | | | 675,000.00 | | 675,000.00 | 0.20 | 135,000.00 |
| PIBD0501B090 | | | | | 182,812.50 | | 182,812.50 | 0.20 | 36,562.50 |
| PIBD0503I197 | | | | | 500,000.00 | | 500,000.00 | 0.20 | 100,000.00 |
| PIBD0504C217 | | | | | 1,400,000.00 | | 1,400,000.00 | 0.20 | 280,000.00 |
| PIBD0505H016 | | | | | | 70,242.19 | 70,242.19 | 0.20 | 14,048.44 |
| PIBD0504L253 | | | | | | 1,025,898.75 | 1,025,898.75 | 0.20 | 205,179.75 |
| Totals | 4,000.00 | 172,204.86 | 6,683,656.25 | 24,310,884.09 | 28,551,797.84 | 26,431,345.03 | 86,153,888.07 | | 17,230,177.62 |

On March 30, 2001, petitioner requested for the refund of P17,230,177.62 from the Large Taxpayers District Office of the BIR (*Exhibit A, inclusive of sub-markings*), citing Section 32(B)(7)(g) of the Tax Reform Act of 1997 (*Republic Act No. 8424*). According to petitioner, R.A. No. 8424 amended paragraph 7(g) of Section 32(B) of the NIRC to expressly provide for the exemption of "gains" from the sale, exchange or retirement of bonds, debentures or other certificates of indebtedness which have maturities of more than five (5) years. Petitioner believed that the "gains" on bond transactions contemplated by the said provision must necessarily include the "interest" on long-term bonds.

To support its stand, petitioner cited BIR Ruling No. 166-99, dated October 25, 1999, providing 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. Petitioner likewise relied on BIR Ruling No. 016-00, dated January 7, 2000, 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: "(S)ince 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 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."

Petitioner waited for a response from the respondent but none was availing. Thus, petitioner was compelled to file on October 15, 2001 the instant petition for review in order to toll the running of the two-year prescriptive period under the law.

On December 10, 2001, respondent filed his Answer, raising the following Special and Affirmative Defenses:

4. He reiterates and repleads the preceding paragraphs of this answer as part of his Special and Affirmative Defenses;

5. Petitioner's alleged claim for issuance of tax credit certificate is still subject to administrative routinary investigation/examination by the respondent's Bureau;

6. Taxes paid and collected are presumed to have been made in accordance with law, hence, not refundable;

7. Petitioner's claim for refund in the amount of P17,230,177.62 as alleged erroneously withheld final tax for the third and fourth quarters of 1999 to the four quarters of 2000 was not fully substantiated;

8. Petitioner's right to claim for refund for the third quarter of 1999 representing the alleged erroneously withheld final income tax has already prescribed pursuant to Section 229 of the Tax Code;

9. Petitioner's instant claim for refund representing the alleged interest income taxes withheld from investments in long term Treasury Bonds is not subject to Section 32(B)(7)(g) of the 1997 Tax Code.

10. It is incumbent upon the latter to show that it has complied with the provisions under Section 204(c) in relation to Section 229 of the Tax Code. Otherwise, its failure to prove the same is fatal to its claim for refund;

11. Claims for refund are construed strictly against the claimant for the same partake the nature of exemption from taxation (***Commissioner of Internal Revenue vs. Ledesma, 31 SCRA 95***) and as such, they are looked upon with disfavor (***Western Minolco Corp. vs. Commissioner of Internal Revenue, 124 SCRA 1211***).

The following are the jointly stipulated issues to be resolved by the court:

1. Whether or not the treasury bonds from which petitioner derived interest income have a maturity of more than five (5) years.

2. Whether or not the Bureau of Treasury withheld final taxes from the petitioner's interest income on long term treasury bonds.

3. Whether or not the gains or interest income derived by petitioner from its investments in long-term treasury bonds is subject to income tax and consequently, to the 20% final withholding tax.

4. Whether or not the right of the petitioner to claim for refund for the third quarter of 1999 representing erroneously withheld final tax on the interest income from long-term bonds had already prescribed pursuant to Section 229 of the Tax Code.

5. Whether or not petitioner is entitled to a refund and/or issuance of tax credit certificate in the amount of P17,230,177.62 representing final taxes withheld on its interest income from treasury bonds with a maturity of over five (5) years.

We shall resolve first the legal issue (*third issue*) for if the same is answered in the affirmative, discussion of the remaining issues (*factual*) is unnecessary.

The issue of whether or not interest income derived from investments in long-term treasury bonds is subject to the 20% final withholding tax is not one of first impression. In a litany of cases decided by this court ***[Malayan Reinsurance Corporation (formerly Eastern General Reinsurance Corp.) versus Commissioner of Internal Revenue, CTA Case No. 6252, July 24, 2002, Resolution dated November 19, 2002; Malayan Zurich Insurance Company, Inc. versus Commissioner of Internal Revenue, CTA Case No. 6251, September 30, 2002; First Nationwide Assurance Corporation versus Commissioner of Internal Revenue, CTA Case No. 6253, October 3, 2002; Rizal Commercial Banking Corporation versus Commissioner of Internal Revenue, CTA Case No. 6228, December 4, 2002; and Malayan Insurance Co., Inc. versus Commissioner of Internal Revenue, CTA Case No. 6243, December 16, 2002;***

***and Tokio Marine Malayan Insurance Company, Inc. (formerly Pan Malayan Insurance Corporation) versus Commissioner of Internal Revenue, CTA Case No. 6254, January 13, 2003]***, we have consistently ruled that only the gain from sale (as distinguished from interest) of bonds, debentures or other certificates of indebtedness with maturity of more than five years shall be exempt from income tax. Interest income earned from investments in long-term FXTNs are subject to the 20% final withholding tax.

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,*** the court first passed upon the issue in this wise:

> "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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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 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", 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.

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.

> 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."

Significantly, our ruling in the above case 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 is impossible not to see that the law did qualify such term and restricted it to gains from sale of bonds.
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> Section 32(B) enumerates the exclusions from gross income. Exclusions, like tax exemptions, are highly disfavored in law. A person claiming a tax exemption must justify his claim by the clearest terms possible because an exemption from the common burden of taxation is not

allowed upon vague implications but on language too plain, to be mistaken. In the instant case, Nippon's claimed exclusion runs counter to the plain, unequivocal language of the law. It resorted to the legislative intent behind the provision to justify departure from the literal meaning but we all know this is prohibited. The only intent that must be given effect is the one expressed in the language of the statute. If a statute is clear, plain and free from ambiguity, it must be given its literal meaning and applied without attempted interpretation. To depart from the meaning expressed by the words of the statute is to alter the statute and legislate, not to interpret. A statute which is plain, clear and free from doubt is not subject to construction; there is no need for interpretation, only application.

In enacting the Tax Reform Act, the legislature may have intended to develop the capital market and encourage savings in long-term investments but even under the restrictive interpretation that gains under the subject provision means gains from sale of bonds, debentures and other certificates of indebtedness, such legislative intent still finds full expression. Section 32(B)(7)(g) as written and as interpreted by the CTA is still an incentive to the development of the bond market because it excludes gains from sales from the computation of the gross income. This may not be as sweeping as Nippon would have wanted to but it is an incentive nonetheless, which is faithful to the legislative intent. Nippon's all or nothing stance on the exclusion of gains from bonds finds no support in either the language or intent of the law.

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."

From the above discussions, it is clear 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. Since the present case involves a claim for refund of the 20% final tax on interest income earned from investments in long-term treasury bonds, the same has no basis in law.

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 ***(Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc., 309 SCRA 87; and Commissioner of Customs vs. Court of Tax Appeals, 328 SCRA 822)***.

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

**SO ORDERED.**

**LOVELL R. BAUTISTA**
Associate Judge

**WE CONCUR:**

**ERNESTO D. ACOSTA**
Presiding Judge

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