REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

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

- versus -

C.T.A. CASE NO. 6254

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JAN 13 2003
[signature]

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DECISION

This case involves a claim for refund or issuance of tax credit certificate in the total amount of P1,773,450.00 allegedly representing erroneously withheld 20% final taxes on interest income derived by petitioner from its investments in long term Fixed Rate Treasury Notes covering the period of May 27, 1999 to November 29, 1999.

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. 2, 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	PIBD0703A011	25-Jan-96	25-Jan-03	P	5,000,000.00	15.500%	P	387,500.00
FXTN 7-5	PIBD0703G051	25-Jul-96	25-Jul-03		9,000,000.00	15.750%		708,750.00
FXTN 10-4	PIBD1007K042	27-Nov-97	27-Nov-07		6,000,000.00	22.875%		686,250.00
FXTN 7-10	PIBD0705D102	30-Apr-98	30-Apr-05		9,700,000.00	20.500%		994,250.00
FXTN 7-12	PIBD0705J124	29-Oct-98	29-Oct-05		24,000,000.00	18.375%		2,205,000.00

For the period covering May 27, 1999 to November 29, 1999, petitioner allegedly received interest income payments on the aforementioned FXTNs in the aggregate amount of P7,093,800.00, net of 20% final withholding tax of P1,773,450.00, broken down as follows:

Treasury Note	Interest Payment Date	Gross Interest Payment	20% Final W/holding Tax	Net Interest Payment
FXTN 7-1	25-Jul-99	P 387,500.00	P 77,500.00	P 310,000.00
FXTN 7-5	25-Jul-99	708,750.00	141,750.00	567,000.00
FXTN 10-4	27-May-99	686,250.00	137,250.00	549,000.00
	29-Nov-99	686,250.00	137,250.00	549,000.00
FXTN 7-10	30-Apr-99	994,250.00	198,850.00	795,400.00
	30-Oct-99	994,250.00	198,850.00	795,400.00
FXTN 7-12	29-Apr-99	2,205,000.00	441,000.00	1,764,000.00
	29-Oct-99	2,205,000.00	441,000.00	1,764,000.00
		P 8,867,250.00	P 1,773,450.00	P 7,093,800.00

On October 25, 1999, the BIR issued BIR Ruling No. 166-99 which provided that the interest income, yield or gain derived from bonds, debentures or other certificates of indebtedness with maturity of more than five years are excluded from gross income subject to income tax in accordance with Section 32(B)(7)(g) of the 1997 Tax Code and therefore, exempt from the 20% final withholding tax imposed under Section 27(D)(1) of the same Code.

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Relying on the said ruling, petitioner, on March 19, 2001, filed a letter-request with the Bureau of Internal Revenue for the refund or tax credit of the amount of P1,773,450.00 alleged to have been erroneously withheld from its interest income on long-term FXTNs from May 27, 1999 to November 29, 1999 (*Exhibits U-1 to U-4; par. 3, Admitted Facts*). 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 with this court on March 23, 2001.

Respondent, in his Answer filed on May 2, 2001, denied petitioner's assertions and prayed for the dismissal of the case.

As contained in the Joint Stipulation of Facts and Issues filed by the parties on September 5, 2001 and approved by this court on September 10, 2001, 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 years is exempt from the 20% withholding tax;

2. Whether or not the treasury notes were in fact purchased by petitioner from the Bureau of Treasury through authorized dealer banks, and if so, can be considered as bonds, debentures or certificates of indebtedness under the Tax Code;

3. Whether or not petitioner is entitled to a refund/tax credit for taxes allegedly withheld on interest income likewise allegedly derived from treasury notes; and

4. Whether or not the claim for refund/tax credit of petitioner is properly substantiated by documentary evidence.

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Petitioner, to support its claim, presented documentary and testimonial evidence. Respondent, on the other hand, merely submitted the case for decision based on the pleadings (*page 103, CTA records*).

Anent the first issue, petitioner maintained that the interest income it derived from its investments in long-term treasury notes is exempt from income tax pursuant to Section 32(B)(7)(g) which provides, thus:

> **SEC. 32.** ***Gross Income.*** –
> 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:
> 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.

Likewise, petitioner cited BIR Ruling No. 166-99 dated October 25, 1999, which provided in pertinent part, thus:

> "B. As a general rule, the interest income on currency bank deposit and <u>yield or other monetary benefit from these "deposit substitutes"</u> 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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> xxx xxx xxx

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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 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)" Underlining supplied.

To further support its stance, petitioner, in its memorandum, cited BIR Ruling No. 016-00, dated January 7, 2000, wherein the BIR reiterated its previous ruling that if the maturity period of the bonds issued through the Bureau of Treasury will be more than five 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 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 period."

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According to the petitioner, the "gains" on the bond transaction contemplated in Section 32(B)(7)(g) must necessarily include "interest" on the long-term bond since the provision also referred to "gains from retirement of bonds, debentures or certificate of indebtedness."

The issue of 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 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:

> "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>;

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(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 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

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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.

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

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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.

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,

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> 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."

This court has likewise reiterated its Nippon case ruling in the following cases: *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 vs. Commissioner of Internal Revenue, CTA Case No. 6228, December 4, 2002; and Malayan Insurance Co., Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6243, December 16, 2002.*

In fine, only the gain from the 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. Since the present case involves 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.

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

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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.
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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