REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

GREAT PACIFIC LIFE ASSURANCE CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 6342

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
MAY 1 1 2004

x - x

DECISION

This is a Petition for Review to compel respondent Commissioner of Internal Revenue (CIR) to issue a tax credit certificate for alleged erroneous withholding of tax by the Bureau of Treasury on interest payments paid to the petitioner in connection with its purchase of treasury notes with a maturity of more than five (5) years on the ground that interest income realized from government securities with a maturity of more than five (5) years are exempt from withholding tax.

The facts of the case as culled from the records are as follows:

Petitioner Great Pacific Life Assurance Corporation, is a company organized and existing under and by virtue of the laws of the Philippines, with principal offices at Grepalife Building, 221 Sen. Gil Puyat Ave., Makati City.

From 1999 to 2001, petitioner purchased Small Denominated Treasury Bonds (SDTs) and Fixed Rate Treasury Notes (FXTNs) *(Annexes "A" to "D", Petition for Review)*.

For the period covering October 15, 1999 to July 15, 2001, the Bureau of Treasury paid interest on the said SDTs and FXTNs to petitioner and withheld tax on said interest at the rate of 20% of the interest income.

On October 5, 2001, petitioner, through its counsel, wrote a letter addressed to the respondent requesting that a refund or a tax credit in the amount of Eight Hundred Nineteen Thousand Five Hundred Three Pesos and 97/100 (P819,503.97) representing the tax withheld by the Bureau of Treasury on the said Small Denominated Treasury Bonds (SDTs) and Fixed Rate Treasury Notes (FXTNs) be issued by the respondent in favor of petitioner. *(Paragraph 3, Joint Stipulation of Facts and Issues)*

However, the respondent has not taken action on petitioner's request. Hence, on October 15, 2001, the petitioner filed the instant Petition for Review with this court in order to compel the respondent to issue a tax credit certificate in its favor relative to the said purchase of treasury notes.

In his Answer filed on November 16, 2001, respondent asserted the following Special and Affirmative Defenses, to wit:

> "4. Petitioner's alleged claim for refund or the issuance of tax credit is subject to administrative routine investigation/examination by respondent's Bureau;
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> 5. Taxes paid and collected are presumed to have been paid in accordance with law, hence, not refundable;
>
> 6. Section 32 (B)(7)(g) of the 1997 National Internal Revenue Code speaks of "*Gains from the sale or exchange or retirement* of bonds, debenture or other certificate of indebtedness with a maturity of *more than five (5) years*" *(Emphasis supplied).* It

refers to gains realized from the sale or exchange or retirement and does not cover interest income, hence, is not exempt from taxation;

7. Assuming but without admitting that the interest income derived by Petitioner's Small Denominated Treasury Bonds can be considered gain, the bonds however, have a maturity of **five years,** hence, do not fall within the purview of the exemption which requires that the maturity of such bonds be **more** than five years. When the law speaks of years, months, days, or nights it shall be understood that years are 365 days each… (Art. 13 NCC). Further, the Rules of Court states under Section 1, Rule 22, Computation of Time – "In computing any period of time prescribed or allowed by these Rule, or by order of the court, or by any applicable statute, the day of the act or event from which the designated period of time begins to run is to be excluded and the date of performance included. If the last day of the period, as thus computed, falls on a Saturday, a Sunday, or a legal holiday in the place where the court sits, the time shall not run until the next working day";

8. Petitioner must prove that it is entitled to the full amount claimed as alleged erroneously withheld tax;

9. Assuming but without admitting the fact that petitioner is entitled to tax refund, it is incumbent upon the latter to show that it has complied with the provisions in SECTION 204 (C) in relation to SECTION 229 of the Tax Code (RA 8824).

"Sec. 204 Authority of the Commissioner to Compromise, Abate & Refund or Credit Taxes. The Commissioner may –
xxx

C. Credit or refund taxes erroneously or illegally received or penalties imposed without authority, xxx. No credit or refund of taxes or penalties shall be allowed unless the taxpayer files in writing with the Commissioner a claim for credit or refund within 2 years after the payment of the tax or penalty: Provided, however, That a return filed showing an overpayment shall be considered a claim for credit or refund. xxx"

"Sec. 229 Recovery of Tax Erroneously or Illegally Collected. –

No suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax hereafter alleged to have been erroneously or illegally collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessively or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner; but such suit or proceeding may be maintained, whether or not such tax, penalty or sum has been paid under protest or duress.

In any case, no such suit or proceeding shall be filed after the expiration of two years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment."

Otherwise its failure to prove the same is fatal to its claim for refund;

10. 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). They are regarded as in derogation of sovereign authority and to be construed *strictissimi juris* against the person claiming the exemption. (Asiatic Petroleum Co. vs. Llanes, 49 PHIL. REP.466)."

During the course of the trial, the parties resolved to lay down the issues to be decided by the court, namely:

1. Whether or not interest income can be considered 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 referred to under Section 32 (B) (7) (g) of the 1997 Tax Code and could therefore be considered exempt from taxes;
2. Whether or not petitioner's Small Denominated Treasury Bonds (SDT's) have a maturity of five (5) years;
3. Whether or not petitioner is entitled to the full amount being claimed as allegedly erroneously withheld tax; and
4. Whether or not the claim for refund/tax credit of Petitioner is properly substantiated by documentary evidence.

(*Joint Stipulation of Facts and Issues, page 53, CTA Records*)

After considering the attending facts, the evidence adduced and the applicable laws and jurisprudence, the court finds for the respondent.

Inasmuch as the crux of contention lies on the correct interpretation of **Section 32(B)(7)(g) of the National Internal Revenue Code (NIRC)**, the court quotes the relevant portions hereunder, to wit:

> "**Section 32. Gross Income.** – x x x
>
> "(B) **Exclusion from Gross Income.** – The following items shall not be included in gross income and shall be exempt from taxation under this Title: x x x
>
> "(7) Miscellaneous Items. – x x x
>
> "(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."

Under said Section 32(B)(7)(g) of the Tax Code of 1997, 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 shall not be included in gross income and thus, exempt from taxation. But the question is, "what does the word "gains" as used in the said section include?"

Petitioner construed the term "gains" in Section 32(B)(7)(g) as broad enough to include the interest from government bonds. To support this view, it cited respondent's own rulings, namely, **BIR Ruling No. 166-99** dated October 25, 1999 and **BIR Ruling No. 016-00** dated January 7, 2000.

In BIR Ruling No. 166-99, respondent ruled that interest income or yields or gains 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, hence, exempt from the 20% final withholding tax on deposit substitutes. BIR Ruling No. 166-99 states thus:

> "x x x 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 Tax Code, provides an exception, thus:
>
> "**Section 32. Gross Income.** – x x x
>
> "(B) **Exclusion from Gross Income.** – The following items shall not be included in gross income and shall be exempt from taxation under this Title: x x x
>
> "(7) Miscellaneous Items. – x x x
>
> "(g) Gains from the sale of Bonds, Debentures or other Certificate of Indebtedness. – Gains realized from the sale or exchange

> or retirement of bonds, debentures or other certificate of indebtedness with a maturity of more than five (5) years."
>
> The idea therefore, is to still treat bonds, debentures or other certificates of indebtedness as "deposit substitutes" the interest income, yield or gain derived therefrom subject to the 20% final tax under Section 27 (D)(1) of the 1997 Tax Code, but exclude said interest income, yield or gain from the gross income if the bonds, debentures or the certificate of indebtedness have maturities of more than five (5) years. Conversely, only the income derived on these instruments with maturity of more than five (5) years shall be excluded from the gross income.
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> **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. 1917 F, 806. (Words & Phrases, gain, page 11, Permanent Edition 18)" *(Emphasis supplied)*

The court, however, has a different opinion on the matter.

Noteworthy is the fact that this case is not one of first impression. Several cases were previously decided by the CTA denying exemption from withholding tax of the interest payment of said treasury notes. Among them is the case of **Nippon Life Insurance Company of the Philippines vs. CIR**, *CTA Case no. 6142, February 4, 2002*. The relevant portions of the jurisprudence are quoted hereunder, thus:

> "**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 the 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 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:

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;
(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. x x x

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. Gains realized from the sale or exchange or retirement of bonds, debentures and other certificate of indebtedness and interests from bonds, debentures and other certificate of indebtedness fall under separate and distinct income categories.

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 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 and 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 "Interest" under Section 32(A) of the Tax Code.** *(Emphasis supplied)*

The court explained further that, "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 been done so in clear and specific terms".

Admittedly, rulings issued by the Commissioner of Internal Revenue command respect and weight and are generally adopted. However, such rulings are not conclusive upon the courts and will be disregarded if found incorrect. In this case, we find the aforementioned administrative interpretations flawed. In fact, the High Tribunal in the case of **Philippine Bank of Communications vs. Commissioner of Internal Revenue**, *G.R. No. 112024, January 28, 1999*, in disregarding a Revenue Memorandum Circular issued by the Commissioner of Internal Revenue, held thus:

> "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, the courts will not countenance administrative issuances that override, instead of remaining consistent with the law they seek to apply and implement.** *(Emphasis supplied)*

Lastly, it is a long-standing principle in taxation that refund claims are strictly construed against the claimant as the same partake the nature of tax exemption (**Commissioner of Internal Revenue vs. Ledesma**, *31 SCRA 95*). Accordingly, they are looked upon with disfavor (**Western Minolco Corp. vs. Commissioner of

Internal Revenue, *124 SCRA 1211*). The party demanding exemption must justify his claim by clear, positive, or express grant of such privilege by law because an exemption from common burden cannot be permitted to exist upon vague implication (**Collector of Internal Revenue vs. Manila Jockey Club, Inc.**, *98 Phil. 670,* cited in **Philippine Bank of Communications vs. Commissioner of Internal Revenue**, *CTA Case No. 2725, January 6, 1988*).

WHEREFORE, the petitioner's claim for issuance of tax credit certificate is hereby **DENIED**.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

We concur:

JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

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 Justice