

Title: Banco de Oro et al. vs. Republic of the Philippines et al. (PEACe Bonds Taxation Controversy)

Facts:

A complex legal dispute arose over the imposition of a 20% final withholding tax on Poverty Eradication and Alleviation Certificates (PEACe Bonds) held by several banks and entities in the Philippines. This legal battle spanned several years, involving various petitions, motions, and resolutions filed by the litigants in different forums, including the Supreme Court of the Philippines.

- ****Issuance of PEACe Bonds****: The Bureau of Treasury released a memo stating that a particular issuance of 10-year Zero-Coupon Bonds would not be subject to the 20% final withholding tax if limited to 19 lenders. Rizal Commercial Banking Corporation (RCBC), on behalf of Caucus of Development NGO Networks (CODE-NGO), won the bid for these bonds and entered into agreements regarding their sale, with the understanding that the interest income was exempt from all forms of taxation based on BIR Ruling Nos. 370-2011 and DA 378-2011.

- ****Imposition of Withholding Tax****: Days before the maturity of the PEACe Bonds, the BIR issued ruling No. 370-2011 stating that these bonds were subject to a 20% final withholding tax as deposit substitutes.

- ****Petitions and Motions Filed****: Petitioners, including several banks and RCBC, filed a Petition for Certiorari, Prohibition, and/or Mandamus, asking for a temporary restraining order (TRO) against the imposition of the final tax. The Supreme Court issued a TRO on the condition that the banks hold the 20% tax in escrow. Subsequently, motions for intervention and reconsideration were filed, questioning, among other things, the correct interpretation of deposit substitutes under Section 22(Y) of the National Internal Revenue Code.

Issues:

1. The proper interpretation and application of the 20-lender rule under Section 22(Y) of the National Internal Revenue Code in relation to government debt instruments.
2. Whether the seller in the secondary market can be the withholding agent for the final withholding tax on income derived from government debt instruments considered deposit substitutes.
3. The validity of BIR Rulings Nos. 370-2011 and DA 378-2011 regarding the taxability of PEACe Bonds.
4. Whether the Bureau of Treasury's refusal to release the withheld amount despite the Supreme Court's directive constituted disregard for court orders.

Court's Decision:

- The Supreme Court nullified BIR Rulings Nos. 370-2011 and DA 378-2011, reiterating the importance of the 19-lender limit in determining whether a debt instrument is a deposit substitute subject to the 20% final withholding tax.
- The Court clarified that the "20 or more lenders at any one time" criterion should be applied at the time of the original distribution of the government securities, meaning if the PEACe Bonds were sold to 20 or more lenders/investors upon issuance, they would be deemed deposit substitutes.
- The Resolution on the motions for reconsideration and clarification upheld the original decision, emphasizing that the non-compliance with the temporary restraining order by the Bureau of Treasury warranted the payment of legal interest on the withheld amount.

Doctrine:

The Supreme Court elaborated on the doctrine regarding the determination of whether a debt instrument is considered a "deposit substitute" subject to a 20% final withholding tax, emphasizing the importance of the "20 or more lenders at any one time" requirement under Section 22(Y) of the National Internal Revenue Code. The decision also underscored compliance with court orders, particularly directives issued under a temporary restraining order.

Class Notes:

- Deposit Substitute Criterion: Under Section 22(Y) of the National Internal Revenue Code, a debt instrument becomes a "deposit substitute" if it is obtained from "20 or more individual or corporate lenders at any one time".
- Withholding Agent: The entity responsible for the withholding of the tax may not strictly be the borrower but could be any person who has control, receipt, custody, or disposal of the income.
- Compliance with Court Orders: Entities are expected to comply with directives issued by the court, including the implementation of temporary restraining orders, with failure to do so resulting in potential penalties including the imposition of legal interest on amounts unjustly withheld.

Historical Background:

The legal dispute over the PEACe Bonds taxability reflects the complexities of tax law in a rapidly evolving financial market. It underscores the tensions between tax collection efforts by the state and the rights of bondholders, within the broader context of efforts to use innovative financial instruments for public welfare projects.