REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Quezon City

Sec 32 (B) (6) (a) and (b) NIRC
BIR Ruling Nos. 442-2012 and 526-2017
OT- 305-2021

OCT 04 2021

MR. BERNARDO G. LAO, JR., Plant Manager
MR. RAFAEL SOLARES, Union President
Legacy Steel Corporation
Alfonso Sandoval Avenue,
Pinagbuhatan, Pasig City

Gentlemen:

This refers to your letter dated August 25, 2016 requesting on behalf of the employees of Legacy Steel Corporation, for exemption from income tax, and consequently from withholding tax, on the employees' retirement benefits received pursuant to a Collective Bargaining Agreement (CBA) entered into between Legacy Steel Corporation and Legacy Steel Workers Union-All Workers Alliance Trade Unions (LSWU-AWATU).

In reply, please be informed that the Labor Code of the Philippines, as amended provides:

1. **Art. 284. Disease as ground for termination.** An employer may terminate the services of an employee who has been found to be suffering from any disease and whose continued employment is prohibited by law or is prejudicial to his health as well as to the health of his co-employees: Provided, That he is paid separation pay equivalent to at least one (1) month salary or to one-half (1/2) month salary for every year of service, whichever is greater, a fraction of at least six (6) months being considered as one (1) whole year.

2. **Art. 287. Retirement.** — Any employee may be retired upon reaching the retirement age established in the collective bargaining agreement or other applicable employment contract.

   In case of retirement, the employee shall be entitled to receive such retirement benefits as he may have earned under existing laws and any collective bargaining agreement and other agreements: Provided, however, that an employee's retirement under any collective bargaining and other agreements shall not be less than those provided herein.

   In the absence of a retirement plan or agreement providing for retirement benefits of employees in the establishment, an employee upon reaching the age of sixty (60) years or more, but not beyond sixty-

five (65) years which is hereby declared the compulsory retirement age, who has served at least five (5) years in the said establishment, may retire and shall be entitled to retirement pay equivalent to at least one-half (1/2) month salary for every year of service, a fraction of at least six (6) months being considered as one whole year." (Underscoring supplied)

The aforesaid provisions allow the separation of the employee on the ground of disease and the retirement of an employee upon reaching the retirement age as may be provided under the applicable CBA or other employment contract entered into by and between the employer and the employees of the company, and the parties to the CBA or contract may agree on the retirement benefits that will be received by the employees provided that such benefits shall not be less than those provided under the Labor Code of the Philippines.

In the absence of a retirement plan or other agreement providing for the retirement benefits of employees in the establishment, the retirement benefits as set forth under the aforequoted provision shall apply, i.e. at least one-half (1/2) month salary for every year of service of an employee who has reached the age of sixty (60) years or more, but not beyond sixty-five (65) years, and rendered at least five (5) years of service in the company.

Considering that there is a CBA existing between Legacy Steel Corporation and the LSWU-AWATU, the provisions of the said CBA shall apply in so far as the employees' retirement benefits are concerned. Article XX of the CBA provides, to wit:

"RETIREMENT PAY

Section 1. The Company shall grant retirement pay to all union members in the amount equivalent to thirty days (30) per year of service upon reaching **the age of 60 years old or when disabled or with serious ailments**." (Emphasis supplied)

On the taxability of the above employee benefits, Section 32 (B) (6) (a) and (b) of the Tax Code of 1997, as amended[1], states, thus:

"Section 32. Gross Income.-

(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

(6) Retirement Benefits, Pensions, Gratuities, etc.-
(a) Retirement benefits received under R.A. 7641 and those received by officials and employees of private firms, whether individual or corporate, in accordance with a reasonable private benefit plan

[1] Further amended by R.A. No. 10963 entitled as "Tax Reform for Acceleration and Inclusion (TRAIN)".

maintained by the employer: Provided, that the retiring official or employee has been in the service of the same employer for at least ten (10) years and is not less than fifty (50) years of age at the time of his retirement: . . ., shall not be included in gross income and shall be exempt from taxation.

(b) Any amount received by an official or employee or by his heirs from the employer as a consequence of separation of such official or employee from the service of the employer because of death, sickness or other physical disability or for any cause beyond the control of the said official or employee." (Underscoring supplied)

Section 32(B)(6)(a) of the Tax Code of 1997, as amended, requires the presence of two conditions in order that the employee benefits received pursuant to a CBA may be granted tax exemption, *viz*: (1) the employee had been in the service of the same private firm for at least ten (10) years; and (2) he is at least fifty (50) years old at the time of retirement.

In addition, Section 32(B)(6)(b) of the Tax Code of 1997, as amended, provides that any amount received by an official or employee or by his heirs from the employer as a consequence of separation of such official or employee from the service of the employer due to death, sickness or other physical disability or for any cause beyond the control of the said official or employee shall not be included in the gross income and shall be exempt from taxation under Title II of the same Tax Code. ***(BIR Ruling No. 197-2015 dated June 10, 2015)***

It must be noted that under Article XX of the CBA, an employee is entitled to retirement pay (1) upon reaching the age of sixty (60) years old or (2) when disabled or (3) with serious ailments.

In such cases, the retirement benefits received under Article XX of the CBA upon reaching the age of 60 years old shall only be exempt from income tax if the two conditions provided under Section 32(B)(6)(a) of the Tax Code of 1997, as amended, are both present, to wit: (1) the employee had been in the service of Legacy Steel Corporation for at least ten (10) years; and (2) he is at least fifty (50) years old at the time of retirement.

While the employee benefits received when the union member is disabled or with serious ailments the law requires the presence of two (2) conditions in order that the employee benefits may be granted tax exemption, namely (1) the employee is separated from the service of the employer due to death, sickness or other physical disability or for any cause beyond the control of the said official or employee, and (2) the employer pays benefits to the official or employee or his heirs as a consequence of such separation. ***(BIR Ruling No. 197-2015 dated June 10, 2015)***

Moreover, pursuant to Section 2.78.1 (A)(7) of RR 2-98, as amended, the terminal pay, *i.e.*, commutation and payment of monetized unused vacation leave credits not exceeding ten (10) days during the year are not subject to income tax and consequently to the withholding tax. Conversely, the cash equivalent of vacation leave exceeding ten (10) days is subject to tax. However, this same principle cannot apply to

sick leave credits since an employee must actually go on sick leave to be able to avail of said leave credits. (*BIR Ruling No. 442-2012* dated July 3, 2012)

It is must be understood that the payment to the retiring employees of their salaries, except if minimum wage earners, and the payment of the 13th month pay and other benefits in excess of the ₱90,000.00[2] threshold shall be subject to income tax, and consequently to withholding tax, under Section 2.78.1 (A)(3)(a) and (A)(7) of RR 2-98, as amended. (*BIR Ruling No. 442-2012* dated July 3, 2012)

Please be guided accordingly.

Very truly yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

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[2] Republic Act No. 10963 increased the threshold from ₱82,000 to ₱90,000 effective January 1, 2018.