April 3, 2019

BIR RULING NO. 224-19

Sec. 79, Tax Code; BIR Ruling No. 003-2004

Government Service Insurance System
Financial Center, Pasay City, 1308 Metro Manila

Attention: *AAA*

Gentlemen :

This refers to your letter dated May 4, 2018 requesting for legal opinion on whether or not withholding tax applies to a possible award of backwages to a former Government Service Insurance System (GSIS) employee. If withholding tax does apply, whether GSIS shall solely apply the withholding tax rate provided under Republic Act (RA) No. 10963 or the TRAIN Law or partially apply the rate provided under the Tax Code of 1997, as amended, for periods covering 2004 to 2017 and apply the TRAIN Law rate starting 2018.

As represented, the GSIS dropped from its rolls, BBB (BBB) on 1 September 2004. BBB subsequently sued GSIS for illegal dismissal.

In a Decision dated 7 August 2001, the Supreme Court affirmed the Court of Appeals' Decision dated 30 November 2010 declaring void GSIS' action of dropping BBB from the rolls on 1 September 2004. The dispositive portion of the Court of Appeals Decisions states:

> "WHEREFORE, premises considered, the petition is hereby GRANTED. The Order issued reassigning petitioner to Zamboanga; the administrative charges filed against petitioner docketed as Adm. Case No. 04-010 for Refusal to Perform Official Duty, etc. and Adm. Case No. 04-009 for Gross Discourtesy in the Course of Official Duty; and the dropping of petitioner from the GSIS roll of employees are hereby declared void. Accordingly, the GSIS is hereby directed to effect the reinstatement of petitioner to his former position or, if it is no longer feasible, to another position of equivalent rank and compensation. It is likewise ordered to pay petitioner his back salaries pertaining to the period during which he was unlawfully dropped from (the) employees' roll."

GSIS filed a Motion for Reconsideration of the said Supreme Court Decision

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which is pending resolution. Meanwhile, GSIS is in the process of computing the possible backwages and benefits that BBB may be entitled to.

In reply thereto, please be informed that the amount received corresponding to the backwages of BBB and the amount representing his unpaid salaries are remuneration for services that are subject to income tax, and, consequently, to the withholding tax on wages. The employer is required to withhold the income tax corresponding to the income actually received as salaries by an employee found to be illegally dismissed, from the time he was reinstated (if he opts to be reinstated instead of separation). However, the illegally dismissed employee is accorded special treatment *i.e.*, he is allowed to allocate or spread his backwages, allowances and benefits through the years he was suspended from service, having been denied payment of his wages when they were due because of circumstances not of his own making and, therefore, beyond his control.

Section 2.57 (B) of Revenue Regulations (RR) No. 2-99, as amended by RR No. 11-18 provides as follows:

> "(B) Creditable Withholding Tax. — Under the creditable withholding tax system, taxes withheld on certain income payments are intended to equal or at least approximate the tax due of the payee on said income. The income recipient is still required to file an income tax return, as prescribed in Sections 51 and 52 of the NIRC, as amended, to report the income and/or pay the difference between the tax withheld and the tax due on the income. Taxes withheld on income payments covered by the expanded withholding tax (referred to in Sec. 2.57.2 of these regulations) and compensation income (referred to in Sec. 2.78 also of these regulations) are creditable in nature."

Whether an employee found to be illegally dismissed is reinstated or opts for separation, he is required to report such income (backwages) for the years he was suspended from service, as he files and pays his corresponding income tax thereon by allocating or spreading his backwages, allowances and benefits through the years from the time of his suspension to actual reinstatement or actual separation (if he opts for separation instead of reinstatement), as the case may be, crediting in the process the corresponding income tax withheld from said wage payments. (BIR Ruling No. 003-2004 dated January 19, 2004)

Thus, in computing BBB's net income tax, the amount deducted and withheld during calendar years he was suspended from service by GSIS shall be allowed as a credit against the tax imposed under Section 24 (A) of the 1997 Tax Code, as amended pursuant to Section 79 (C) (2) of the same Code. Moreover, he is allowed to deduct personal and additional exemptions during the years (before the effectivity of RA No. 10963) he was suspended in accordance with Section 35 (A) and (B) also of the same Code.

Such being the case, **said backwages and the amount representing his unpaid salaries are subject to income tax and consequently, to the withholding tax on wages pursuant to Section 79, Chapter XIII, Title II of the 1997 Tax Code, as amended and as implemented by RR No. 2-98, as amended by RR No. 11-18** (BIR Ruling No.

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003-2004 dated January 19, 2004). GSIS shall apply the withholding tax rate as provided thereunder for the years prior to 2018 and apply the withholding tax rate provided under RA No. 10963 for the years beginning 2018.

On the other hand, the amount representing the 13th month pay of BBB received from the time he was constructively dismissed up to the time of his reinstatement is exempt from income tax, the same being treated as an exclusion from the gross income under Section 32 (B) (7) (e) of the Tax Code of 1997, as amended.

Please be guided accordingly.

Very truly yours,

(SGD.) CAESAR R. DULAY
Commissioner of Internal Revenue

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