REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Quezon City

Sec. 32(B)(6)(b) NIRC
BIR Ruling No. 435-2011
#231-2016
6-1-2016

DEPARTMENT OF LABOR AND EMPLOYMENT
Intramuros, Manila

Attention: **Hon. Rosalinda Dimapili-Baldoz**
DOLE Secretary

Gentlemen:

This refers to your letter dated May 18, 2016 requesting exemption from income tax, and consequently from withholding tax, on the early retirement benefits/separation benefits to be received by displaced teaching and non-teaching personnel of higher educational institutions (HEIs) brought about by the implementation of the K to 12 Program.

It is represented that the K to 12 Program is a flagship program of the Aquino Administration which introduces two (2) years of Senior High School in the basic education; that to diffuse tension in its implementation, part of the National Conciliation and Mediation Board (NCMB) conciliated formula for settlement agreement is early retirement package for teaching and non-teaching personnel, while others are through retrenchment package or separation pay; and that since the displacement of said personnel is beyond their control or that of the HEIs, the amounts they will receive are exempt from taxation.

In reply thereto, please be informed that pursuant to Section 32(B)(6)(b) of the Tax Code of 1997, as amended; any amount received by an official or employee as a consequence of separation of such official or employee from the service of the employer because of death, or sickness or other physical disability or for any cause beyond the control of the said official employee shall not be included in the computation of his gross income and shall be exempt from taxation.

The phrase "for any cause beyond the control of said official or employee" connotes involuntariness on the part of the official or employee. The separation from the service of the official or employee must not be asked for or initiated by him. The above-mentioned provision 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

041916

pays benefits to the official or employee or his heirs as a consequence of such separation.

Foregoing considered, this Office is of the opinion, as it hereby rules, that the retrenchment/separation from employment of the personnel of HEIs by reason of the implementation of the K to 12 Program falls within the meaning of the phrase "for any cause beyond the control of the said official or employee" considering that the implementation of the said Program was neither asked for nor initiated by the employees. Accordingly, retrenchment/separation benefits that will be received by the displaced personnel of the HEIs by reason of the implementation of the K to 12 Program shall not be subject to income tax, and consequently to the withholding tax, pursuant to Section 32(B)(6)(b) of the Tax Code of 1997, as amended.

With regard to the retirement benefits, Section 32 (B) (6) (a) of the Tax Code of 1997, as amended, 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 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."*

Based on the above-quoted provision, if the company maintains a reasonable private retirement plan, the retirement benefits that will be received by the employees shall be exempt from income tax, provided that the two (2) conditions set forth under Section 32(B)(6)(a) of the Tax Code are met, *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. Hence, HEIs, which have reasonable retirement benefit plans, may grant their displaced employees retirement benefits without subjecting the same to withholding income tax provided that the age and length of service requirements under Section 32(B)(6)(a) of the Tax Code are satisfied.

In case the HEIs do not have reasonable retirement benefit plans, Section 1 of RA No. 7641, amending the Labor Code of the Philippines, provides for the retirement pay to qualified private sector employees in the absence of any retirement plan in the establishment, to wit:

> *"Section 1. Article 287 of Presidential Decree No. 442, as amended, otherwise known as the Labor Code of the Philippines, is hereby amended to read as follows:*
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> *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."*

Pursuant to the above provision, 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 RA 7641 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. The retirement benefits of employees who met the age and length of service requirement under RA 7641 shall also be exempt from withholding income tax by express provision of Section 32(B)(6)(a) of the Tax Code, as amended.

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. 435-2011* dated November 9, 2011)

231-2016
5-1-2016

It must be understood that the payment to the displaced employees of salaries and the 13th month pay and other benefits in excess of the PhP 82,000.00[1] 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.

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation it will be disclosed that the facts are different, then this ruling shall be considered null and void.

Very truly yours,

KIM S. JACINTO-HENARES
Commissioner of Internal Revenue

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[1] Republic Act (R.A.) No. 10653, "An Act Adjusting the 13th Month Pay and other Benefits Ceiling Excluded from the Computation of Gross Income for Purposes of Income Taxation, Amending for the Purpose Section 32(B), Chapter VI of the National Internal Revenue Code of 1997, as Amended." R.A. No. 10653 is being implemented by Revenue Regulations No. 3-2015.