August 30, 2019

BIR RULING NO. 471-19

Sec. 57 (B), NIRC & RR 6-01; 000-00

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Attention: *AAA*

Gentlemen :

This refers to your letter dated March 26, 2018 requesting on behalf of your clients, the former employees of **Philips Export Industries, Inc. (Philips)** numbering about 791, represented by their duly authorized representatives namely: BBB, CCC and DDD, for exemption from income tax, capital gains tax and/or withholding tax, documentary stamp tax and other pertinent taxes on their awards for separation pay and other damages against their employer.

As represented, sometime in January of 2004, your clients who are the complainant-employees of Philips filed a case before the National Labor Relations Commission (NLRC) for Illegal Dismissal, Underpayment/Non-payment of Salaries/Wages, Service Incentive Leave Pay, 13th Month Pay, Separation Pay, Moral and Exemplary Damages against their employer, which was docketed as *EEE, BBB, et al. vs. Philips Export Ind., Inc./Yong Sung Electronics, Inc.*, NLRC Case Nos. RAB IV-09-16169-02-C; RAB IV-09-10333-98-C; and RAB IV-11-16441-02-C.

On September 29, 2005, the NLRC rendered a decision in favor of the 791 employees which decision later on became final and executory for failure of the defendant to file an appeal or a Motion for Reconsideration. [1] Prior to the release of the Decision, Philips caused the transfer of all of their assets, real and personal, to Yong Sung Corp. (Yong Sung) whose President is one of Philip's Directors. The transfer was declared by the NLRC as illegal for being done purposely to evade liability to complainant-employees.

Prior to the execution of the Decision, Philips and/or Yong Sung again caused the transfer of all of Philips' assets from Yong Sung to Yu Jin, Inc. (whose President is also the same President of Yong Sung). The transfer was opposed by the complainants and declared by the NLRC as illegal. [2] On November 14, 2016, the complainant-employees was able to successfully levy and acquire through public auction certain real and personal

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properties of Philips. [3]

You now seek to (1) clarify whether the amounts received by the complainants-employees from their employer on account of their separation from service are exempt from tax; and (2) request for exemption from payment of taxes on the transfer of real properties successfully levied and acquired through public auction.

In reply thereto, please be informed that the amount received corresponding to the backwages of the 791 employees and the amount representing their unpaid salaries are remuneration for services that are deemed to have been performed by them for Philips prior to or during the period of their illegal dismissal from the service as declared by the NLRC. Such being the case, said backwages and the amount representing their 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 Tax Code as implemented by Revenue Regulations No. 2-98, as amended. (BIR Ruling No. 003-2004 dated January 19, 2004)

In filing their respective annual income tax returns, the 791 employees should report as income and pay their income taxes by allocating or spreading their backwages and the amounts paid to them as unpaid salaries, for the corresponding years such wages or salaries have been earned.

On the other hand, **the amount representing the 13th month pay of the 791 employees received from the time they were constructively dismissed up to the time of their 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**.

In addition, **the award of moral and exemplary damages is not subject to withholding tax. Neither is the attorney's fee, the same being merely a reimbursement of the 791 employees' expenses or advances in the course of litigation**.

As to the issue of whether the transfer of the real properties in favor of the complainant-employees is subject to the applicable creditable withholding tax (CWT), we rule in the affirmative. The real properties subject to transfer are ordinary assets of Philips since the same are used in the latter's business. Accordingly, Section 2.57.2 (J), Revenue Regulations (RR) No. 2-98, as amended by RR No. 6-2001, implementing Section 57 (B) of the Tax Code of 1997, as amended, shall apply. Thus, **the conveyance of the aforesaid real properties in favor of the complainant-employees by way of auction sale as payment of unpaid salary, backwages and benefits plus damages is subject to the applicable CWT**.

Section 2.57.3 of RR No. 2-98, as amended, providing for persons required to deduct and withhold the CWT, states that insofar as taxable sales, exchanges or transfers of real property are concerned, the buyers are constituted as withholding agents.

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Although Philips is the one liable to pay the CWT, the complainant-buyers are constituted as the withholding agents required to withhold the CWT.

With regard to the tax base for the computation of CWT and Documentary Stamp Tax (DST), the CWT and DST shall be paid based on whichever is the highest of the consideration (bid price) or the fair market value or the zonal value as determined in accordance with Section 6 (E) of the Tax Code of 1997, as amended.

The penalty, surcharge and interest for late payment of the above taxes shall not be imposed considering that a difficult question of law as to the tax treatment of the foregoing circumstances exists. [Sec. 2 (2.4) of Rev. Regs. No. 13-2001] However, this waiver of the penalty, surcharge and interest shall be effective only up to the time this ruling is received.

Finally, the Certificate Authorizing Registration (CAR) on the transfer of the above realties in the name of the complainant-employees shall be issued immediately after payment of the DST and CWT as prescribed under Sections 196 and 57 (B), respectively, of the Tax Code of 1997, as amended.

IN VIEW OF THE FOREGOING, the transfer of real properties, by virtue of the Certificate of Sale/Award through auction sale, in favor of the complainant-employees is subject to CWT pursuant to Section 57 (B) of the Tax Code of 1997, as amended, and as implemented by Section 2.57.2 (F) of Revenue Regulations (RR) No. 2-98, as amended by RR 11-2018 and DST pursuant to Section 196 of the same Tax Code.

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

Very truly yours,

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

Footnotes

1. Certified copy of the Decision is attached as Annex "B".
2. Photocopy of the Decision is attached as Annexes "C" and "D".
3. Copy of Certificate of Sale/Award evidencing auction sale is attached as Annex "E".

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