December 9, 2019

BIR RULING NO. 772-19

Section 32 (B) (6) (b), 1997 NIRC; BIR Ruling No. 192-2016; BIR Ruling No. 479-2014

Aboitiz Foundation, Inc.
Aboitiz Corporate Center
Gov. Manuel A. Cuenco Ave.
Kasambagan, Cebu City

Attention: *AAA*

Gentlemen :

This refers to your letter dated June 6, 2016 requesting for a ruling confirming that the separation pay given to BBB, an employee of Aboitiz Foundation, Inc. (AFI for brevity) who was separated from service due to the implementation of a redundancy program is exempt from withholding tax pursuant to Section 32 (B) (6) (b) of the Tax Code of 1997, as amended.

It is represented that AFI (TIN 000-000-000-000) is a non-stock, non-profit entity duly registered with the Securities and Exchange Commission (SEC) under SEC Company Reg. No. CEO1778. AFI is primarily a socio-economic assistance body and as such, it operates exclusively for charitable, social welfare, religious, scientific, cultural, non-formal education, and youth and sports development purposes. AFI, consistent with its commitment to promote social development, has engaged in microfinance operations to provide financial loans to various small-scale businesses and entrepreneurs within identified developing communities. AFI management sees the need for a professionally run organization with an established experience in microfinance operations to take over the operation and administration of AFI's outstanding Microfinance Loan Portfolio. On February 24, 2016, AFI through the office of its Chairman of the Board of Trustees, entered into a Memorandum of Agreement (MOA) with Center for Agriculture and Rural Development (CARD), Inc., a non-stock, non-profit corporation engaged in providing multi-purpose microfinance loan facilities to persons situated in identified developing communities in the Philippines. The MOA basically transfers to CARD the management of the Microfinance Loan Portfolio of AFI that resulted to the ceasing of the microfinance activities of the foundation. The transfer of the said Microfinance Loan Portfolio to CARD made it necessary for management to review and rationalize its current workforce

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structure, with the aim of placing the right number of qualified people in the organization. The review resulted to a restructuring wherein certain positions were considered as feasible for merging with other existing positions while others were deemed operationally unnecessary. As a consequence, certain existing positions were taken out in AFI's plantilla leading to workforce reduction.

After signing the MOA, meetings were held with affected employees, where redundant positions were identified. Subsequently, AFI's Board of Trustees, during its regular meeting on April 18, 2016 affirmed the management's redundancy program, taking effect after approval of the MOA entered into by AFI and CARD, involving certain positions affected by the ceasing of microfinance activities. While this re-organization may cause involuntary severance of employment, AFI has offered separation benefits package in strict compliance with the basic requirements of the Labor Code and other social legislation. The Redundancy Program has to be implemented by phases in order to give affected employees an opportunity to seek new employment. The position of BBB was one of those positions identified and notifications were sent to her on this matter in compliance with the due process, which she acknowledged with no objections through a letter.

In reply, 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 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. 416-2012 dated June 25, 2012)

The above-mentioned 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.

Submitted documents show that AFI has already informed the Department of Labor and Employment (DOLE-Regional Office 7, Cebu City Field Office) on January 29, 2016 thru an Establishment Termination Report stating that the afore-mentioned employee has been separated from employment due to redundancy and that the said worker has been duly notified of her termination.

Accordingly, the separation pay to be received by the retrenched employee as a result of her separation from the service is exempt from income tax and consequently from the withholding tax prescribed by Section 79 of the 1997 Tax Code, as implemented by Revenue Regulations (RR) No. 2-98, as amended by RR Nos. 6-2001 and 12-2001.

Moreover, pursuant to Section 2.78.1 (A) (7) of RR 2-98, as amended, the terminal

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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.

It is, however, understood that this exemption does not include the payment of the separated employee's salaries and the payment of the 13th month pay and other benefits in excess of the Php82,000.00 [1] threshold under Section 2.78.1 (A) (3) (a) and (A) (7) of RR 2-98, as amended. (BIR Ruling Nos. 192-2016 dated May 16, 2016 and 479-2014 dated December 3, 2014)

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 as null and void.

Very truly yours,

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

Footnotes

1. As amended by Revenue Regulations No. 3-2015 dated March 13, 2015.

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