REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Quezon City

Sec. 79, Tax Code
BIR Ruling No. 003-2004
0501-2019
SEP 06 2019

HON. ISIDRO S. LAPEÑA
Director General for Technical Education and Skills Development Authority
East Service Road
South Luzon Expressway, Taguig City

Dear Secretary Lapeña,

This refers to your letter dated January 18, 2019 relative to the tax implications of back salaries, allowances and other benefits of former employees who were dismissed from the government service on March 2013 but reinstated on April 2018 per CA-G.R. SP No. 129951 issued by the Court of Appeals. Specifically, you are requesting for the following:

1. Legal opinion on the taxes to be withheld from and remitted for back salaries benefits; and
2. Condonation of penalties and charges for non-withholding of taxes, if any.

In reply, please be informed that the amount received corresponding to the backwages of the dismissed employees and the amount representing their unpaid salaries are remuneration for services that are subject to income tax, and, consequently, to the withholding tax on wages. Technical Education and Skills Development Authority (TESDA) as employer is required to withhold the income tax corresponding to the income actually received as salaries by employees found to be illegally dismissed, from the time they were illegally dismissed up to the time of their reinstatement (if they opt to be reinstated instead of separation). However, the illegally dismissed employees are accorded special treatment i.e., they are allowed to allocate or spread their backwages, allowances and benefits through the years they were separated from service, having been denied payment of their wages when they were due because of circumstances not of their own making and, therefore, beyond their control.

Section 2.57 (B) of Revenue Regulations (RR) No. 2-98, 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 Section 51

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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".

This Office had occasion to rule that 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 separated from service, and he must file and pay his corresponding income tax thereon by allocating or spreading his backwages, allowances and benefits through the years from the time of his dismissal 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 the dismissed employees' net income tax, the amount deducted and withheld during calendar years they were dismissed from service by TESDA 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, they are allowed to deduct personal and additional exemptions during the years (before the effectivity of RA No. 10963) they were dismissed in accordance with Section 35 (A) and (B) also of the same Code.

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 1997 Tax Code, as amended and as implemented by RR No. 2-98, as amended by RR No. 11-18** (BIR Ruling No. 003-2004 dated January 19, 2004). TESDA 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 the dismissed 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.

Finally, the penalty, surcharge and interest for late payment of the above taxes shall not be imposed since TESDA's failure to remit is due to the illegal dismissal case pending in court (Sec. 2.7 of Revenue Regulations No. 13-2001). However, this waiver of the penalty, surcharge and interest shall be effective only up to the time this ruling is received.

Please be guided accordingly.

Very truly yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

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