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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MARCOS F. CATALAN,
Petitioner,

-versus -

C.T.A. CASE NO. 4345

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

11/11/91

x - - - - - - - - - - - - - - x

D E C I S I O N

This is a simple claim for refund by petitioner covering the amount of P28,271.53 representing income tax withheld from the accumulated unused vacation and sick leave credits of petitioner who retired from the government service.

It appears from the records of the case that petitioner has retired from Philippine National Bank under the provisions of Republic Act No. 1616, as amended, on March 3, 1987. Upon his retirement, petitioner was entitled to the payment of the money value of his accumulated unused vacation and sick leave credits in the amount of P172,149.28. The amount of P28,271.53 was withheld as income tax from the said amount. On September 15, 1988, petitioner formally filed with respondent a claim for the refund of the withheld amount. However, respondent failed to act on the said claim before the expiration of the two-year prescriptive period, hence, petitioner instituted this Petition for Review on March 2, 1989.

Petitioner advance the following reasons in support of his claim for refund:

> a. The commutation (or payment of the money value) of unused leave credits is part of the retirement benefits of an employee retiring under the provisions of R.A. No. 1616, as amended.
>
> b. Presidential Decree No. 220 specifically provides that "provisions of any exisiting law to the contrary notwithstanding, <u>social security benefits, retirement gratuities, pensions and other similar benefits received by retiring employees and workers</u>, whether received from Philippine or foreign government agencies and other institutions, private or public, <u>shall be exempt from the payment of income tax</u>." (Underscoring supplied.)
>
> c. Since commutation of unused leave credits is granted under the GSIS Law (C.A. No. 1986, as amended by R.A. No. 1616) and therefore is also a GSIS retirement benefit, which is not included in gross income and is exempt from taxation, under Section 28(b)(7) of the National Internal Revenue Code.

Petitioner further cited previous decisions by this Court such as <u>Efren P. Castaneda vs, The Commissioner of Internal Revenue</u>, CTA Case No. 3809, February 4, 1987 and <u>Florencio E. Santos vs.</u>

The Commissioner of Internal Revenue, CTA Case No. 4004, November 18, 1987, wherein the court ruled on the entitlement of retirees to the refund of the taxes withheld from the accumulated vacation and sick leave credits.

Respondent on his part admits the basic facts narrated in the Petition for Review. However, he raises questions that the Castaneda case is still pending resolution by the Supreme Court while the Santos case has been resolved only in a minute resolution by the Supreme Court. He reiterated his stand that the money value of vacation and sick leaves are part of compensation for services rendered and therefore subject to income tax. This case was withdrawn by the petitioner in view of the adverse opinion by the Supreme Court in the case of Justice Oscar Victoriano, G.R. 831765, August 10, 1989 holding his terminal leave subject to income tax but with permission of this Court was reinstated in view of the subsequent favorable opinion of the Supreme Court in the administrative case of Mr. Bernardo F. Zialcita, A.M. 90-6-015-SC, August 23, 1990.

The issue presented for resolution of this Court is whether or not the money value of the accumulated vacation and sick leave credits are subject to income tax.

This Court has consistently ruled in the case cited of Efren P. Castaneda vs. The Commissioner of Internal Revenue & Florencio E. Santos vs. The Commissioner of Internal Revenue, that the money value of the terminal leave credits of retiring government employees are exempted from income tax. We cited in support of this stand Commonwealth Act No. 186, as amended by R.A. 1616, Presidential Decree No. 220 and Section 29(b)(7) of the National Internal Revenue Code (now Section 28(b)(7)). This Court was affirmed by the Supreme Court in both instances in the cases of Commissioner of Internal Revenue vs. The Court of Appeals and Efren Castaneda, G.R. No. 96016 dated October 17, 1991 and Commissioner of Internal Revenue vs. Court of Tax Appeals and Florencio E. Santos, G.R. No. 81362 dated July 4, 1988. The affirmation by the Supreme Court of the Castaneda case was in confirmation of an earlier decision by the Court of Appeals in C.A.-G.R. SP No. 20482 dated September 26, 1990 likewise sustaining the position taken by the Tax Court on the merits of the claim for refund of Efren Castaneda.

The Supreme Court in another case involving administrative settlement of the claim of Bernardo F. Zialcita, Deputy Clerk of Court, ordered the Fiscal Management & Budget Office the refund of the tax withheld from his terminal leave. The court holds that the terminal leave pay can never be considered part of his salary subject to the payment of income tax but falls under the phrase "other similar benefits received by retiring employees and workers", within the meaning of Section 1 of P.D. 220 and therefore exempt from income tax. It is in this case that the Supreme Court differentiated the case of Zialcita with the case of Justice Victoriano. While the case of Zialcita involves payment of terminal leave by reason of compulsory retirement, in the case of Victoriano, the terminal leave pay he received when he applied for optional retirement had been converted into vacation and sick leave with commutation of salary which forms part of his regular salary subject to income tax. The conversion and commutation were done because before the effectivity of his optional retirement on December 31, 1982, he was appointed Acting Commissioner of the Land Registration Commission on

November 19, 1982.

In still another recent administrative case of Jesus N. Borromeo vs. The Hon. Civil Service Commissioner, et al., G.R. No. 96032, 31 July 1991, the Court explained the rationale behind the employee's entitlement to an exemption from withholding (income) tax on his terminal leave pay, as follows:

> "xxx commutation of leave credits, more commonly known as terminal leave, is applied for by an officer or employee who retires, resigns or is separated from the service through no fault of his own. (Manual on Leave Administration Course for Effectiveness published by the Civil Service Commission, pages 16-17). In the exercise of sound personnel policy, the Government recognizes that for most public servants, retirement pay is always less than generous if not meager and scrimpy. A modest nest egg which the senior citizen may look forward to is thus avoided. Terminal leave payments are given not only at the same time but also for the same policy considerations governing retirement benefits."

In fine, not being part of the gross salary or income of a government official or employee but a retirement benefit, terminal leave pay is not subject to income tax.

WHEREFORE, in view of this clear and consistent pronouncement by the Supreme Court, respondent is hereby ordered to refund to petitioner the amount of P28,271.53 representing erroneously withheld tax from the money value of his terminal leave.

SO ORDERED.

Quezon City, Metro Manila, November 11, 1991.

ERNESTO D. ACOSTA
Associate Judge

WE CONCUR:

ALEX Z. REYES
Presiding Judge

CONSTANTE C. ROAQUIN
Associate Judge

C E R T I F I C A T I O N

I hereby certify that this decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ALEX Z. REYES
Presiding Judge
Court of Tax Appeals