L-B

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

ORLANDO M. ESCAREAL,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 5194

Promulgated:
SEP 02 1996

x -- x

DECISION

This is a petition for review seeking the reversal of the January 19, 1995 decision of the Assistant Commissioner of the Bureau of Internal Revenue (BIR), denying petitioner's application for refund of withheld income taxes plus interest on his backwages, bonuses and cash value of his accrued vacation leave covering the period 1988 to 1991, all received in 1993.

The facts, as narrated in the petition, are as follows:

On September 16, 1977, petitioner was hired by Philippine Refining Inc., (now Unilever Philippines Inc.), PRC for brevity, as a Pollution Control Manager, and subsequently designated as Safety Manager. On June 15, 1988, petitioner received a notice that the position of "Safety and Pollution Control Manager will be declared redundant effective at the close of work hours on 15th July 1988."

Petitioner challenged the validity of his termination from employment before the PRC, the Labor Arbiter, the National Labor Relations Commission and ultimately the Supreme Court which rendered a ruling, dated September 2, 1992, stating that petitioner was illegally terminated from his employment and is therefore entitled to the award of backwages from August 16, 1988 to July 21, 1991, inclusive of allowances and monetary equivalent of other benefits due him for that period, as well as his retirement pay and other benefits provided under PRC's compulsory retirement scheme.

PRC was therefore obligated to pay the petitioner the sum of ONE MILLION TEN THOUSAND THIRTY ONE AND 25/100 PESOS (P1,010,031.25), representing backwages, bonuses and the cash value of his vacation leaves from August 16, 1988 to July 21, 1991 (Exh. A). The corresponding withholding tax amounting to P292,636.00 was withheld and remitted by PRC to the BIR on March 10, 1993 (Exhs. B, B-1 and C).

On December 28, 1994, petitioner filed a claim for refund with the BIR, in the amount of P292,636.00, alleging that the amount received from PRC are excluded from gross income and, therefore, exempt from the income tax pursuant to Section 28(b)(7)(B) of the National Internal Revenue Code (NIRC), as amended (Exh. D). On January 30, 1995, petitioner received a letter from Ms. Alicia P. Clemeno, Assistant Commissioner of the BIR, dated January 19, 1996 (Exh. E), which partially read as follows:

> "In reply, please be informed that pursuant to Section 28(b)(7)(B) of the Tax Code as amended, the backwages including bonuses paid to you cannot be considered as benefits paid as a consequence of an involuntary separation from the service of the employer within the contemplation of Section 28(b)(7)(B) of the Tax Code but as remunerations from services that would have been rendered by you for your employer prior to 1993 when actually received or during the period of illegal dismissal from the service which was affirmed by the Supreme Court. Such being the case, said backwages are subject to income tax and consequently to the withholding tax on wages pursuant to Section 72, Chapter 10, Title II of the Tax Code as implemented by Revenue Regulations No. 6-82 as amended.
>
> However, considering that such backwages and bonuses received constitute remunerations for services that would have been performed by your prior to the year (1993) when actually received or during the period of your dismissal from the service which no less than the Supreme Court has in effect affirmed to be illegal, and having been denied payment of wages when they were due because of circumstances not of your own making and therefore beyond your control, you should report as income and pay the respective income taxes by allocating or spreading the backwages and bonuses for the years 1988, 1989, 1990 and 1991 and crediting the corresponding income tax withheld from said wage payments excluding the accrued leave pay which has been ruled by the Supreme Court as

not subject to income tax. (CIR vs. Court of Appeals and Efren P. Castaneda, G.R. No. 96016)

Accordingly, your claim for refund may be processed by this Office upon the submission of the following documents for verification purposes:

1. Certification from your employer showing a breakdown of the total backwages and other benefits received per year in the total amount of P1,010,031.00 including the total amount of withheld taxes; and

2. Certificate/proof of remittance of tax withheld.

Please submit the requested documents immediately in order that herein claim can be acted upon."

On February 6, 1995, petitioner simultaneously filed an appeal with the respondent, Commissioner of Internal Revenue (Exh. F), and with this Court. Petitioner is asking this Court to issue an order directing the respondent to refund the amount of P292,636.00, representing alleged illegally withheld income tax plus 6% interest per annum from the time the withholding was made up to the time the refund is effected.

On March 1, 1995, during the pendency of this case, respondent approved the refund of P113,064.20, pursuant to Section 204 of the NIRC, computed as follows: (Exh. G, Annex "H" of Pet's. Request for Admission, pp. 59-60, CTA record)

"COMPUTATION

1988

Gross Income:		
Backwages	P103,950.00	
Bonuses	23,100.00	P127,050.00
Less: Personal & additional exemptions		15,000.00
Net Income		P112,050.00
Tax Due		P 16,567.00

1989

Gross Income:		
Backwages	P277,200.00	
Bonuses	46,200.00	P323,400.00
Less: Personal exemption		12,000.00
Net Income		P311,400.00
Tax Due		P 67.481.00

1990

Gross Income:		
Backwages	P277,200.00	
Bonuses	46,200.00	P323,400.00
Less: Personal exemption		12,000.00
Net Income		P311,400.00
Tax Due		P 67,481.00

1991

Gross Income:		
Backwages	P154,770.00	
Bonuses	23,100.00	P177,870.00
Less: Personal exemption		18,000.00
Net Income		P159,870.00
Tax Due		P 28,043.80

Summary:

Tax Due per year:		
1988	P 16,567.00	
1989	67,481.00	
1990	67,481.00	
1991	28,043.00	P179,572.00
Less: Tax Withheld by employer		292,636.00
Balance (Refundable)		(P113,064.00)

Note: Tax due was computed based on data furnished by taxpayer and employer (PRC) (pls. see pp. 61-76)
Taxpayer has no listed tax liability (p. 60)."

Not satisfied with the partial refund awarded by respondent, petitioner pursued his claim for refund with respect to the balance of P179,572.00 plus 6% interest per annum from the time of withholding up to the time the refund is effected. Petitioner alleged that backwages and bonuses are not subject to income tax because these are excluded from gross income under Sec. 28(b)(7)(B) of the NIRC. The award for payment of backwages was due as a consequence of his illegal dismissal. And certainly beyond his control.

The issues presented to us are purely legal. First, whether or not backwages and bonuses falls within the purview of Sec. 28(b)(7)(B) of the NIRC. If so, then its is not subject to the withholding tax. Second, if petitioner is found to be entitled to the refund claimed, whether or not petitioner is entitled to an interest at the rate of 6% from the time of withholding up to the time the amount claimed is refunded.

Section 28(b)(7)(B) of the NIRC, provides:

"Sec. 28. *Gross Income.*- x x x.

(b) ***Exclusions from gross income.*** - The following items shall not be included in gross income and shall be exempt from taxation under this Title:

> x x x x x x x x x.
>
> (7) *Retirement benefits, pensions, gratuities, etc.* - x x x.
>
> (B). Any amount received by an official or employee or by his heirs from the employer as a consequence of <u>separation</u> 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 said official or employees." (Underscoring ours.)

The exemption contemplated in this provision refers to the amount received by an individual or his heirs on account of his separation due to either:

1) death, sickness or other physical disability; or

2) for any cause beyond the control of said official or employee.

For all intent and purposes, the aforesaid provision of law points at a scenario where there must be actual separation from the service and such separation must be beyond the control of said employee. Section 2 of Revenue Regulations No. 6-82, as amended by Revenue Regulations No. 12-86, provides:

> "(2) 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 other cause beyond the control of the said official or employee, <u>such</u>

as retrenchment, redundancy and cessation of business.

The phrase 'for any cause beyond the control of the 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.

Whether or not the separation is beyond the control of the said official or employee shall be determined on the basis of prevailing facts and circumstances. This shall be duly established through competent evidence to be submitted by the employer which should be attached in his monthly report for the period in which the amount was paid due to involuntary separation.

Any payment made by an employer to an employee on account of dismissal, that is, for causes other than those mentioned in paragraph (b)(2) hereof, constitutes compensation regardless of whether the employer is legally bound by contract, statute, or otherwise to make such payment."

In the case at bar, the Supreme Court has awarded petitioner backwages from August 16, 1988 to July 21, 1991, inclusive of allowances and the monetary equivalent of other benefits due him for that period, as well as his retirement pay and other benefits provided under the employer's (PRC), compulsory retirement scheme. The rationale behind the award of backwages and retirement benefits is stated in this wise:

"In this regard, it could be concluded that the respondent PRC was merely in a hurry to terminate the services of the petitioner as soon as possible in view of the latter's impending retirement; it appears that said company was merely trying to avoid paying the retirement benefits the petitioner stood to receive upon reaching the age of sixty (60). PRC acted in bad faith.

x x x x x x x x x.

Coming to the third assigned error, since We have concluded that the petitioner's dismissal was illegal and can not be justified under a valid redundancy initiative, Article 283 of the Labor Code, as amended, on the benefits to be received by the dismissed employee in the case of redundancy, retrenchment to prevent losses, closure of business or the installation of labor saving devices, is not applicable. Instead, We apply Article 279 thereof which provides, in part, that an 'employee who is unjustly dismissed from work shall be entitled to reinstatement without loss of seniority rights and other privileges and to his full backwages, inclusive of allowances, and to his other benefits or their monetary equivalent computed from the time his compensation was withheld from him up to the time of his actual reinstatement.'

In *Torillo vs. Leogardo, Jr.*, an amplification was made on Article 279 of the Labor Code and the distinction between separation pay and backwages. Citing the case of *Santos vs. NLRC*, We held in the former:

> 'The normal consequences of a finding that an employee has been illegally dismissed are, firstly, that the employee becomes entitled to reinstatement to his former position without loss of seniority rights and, secondly, the payment of backwages corresponding to the period from his illegal dismissal up to actual reinstatement.
>
> x x x

> Though the grant of reinstatement commonly carries with it an award of backwages, the inappropriateness or non-availability of one does not carry with it the inappropriateness or non-availability of the other.
>
> x x x
>
> Put a little differently, payment of backwages is a form of relief that restores the income that was lost by reason of unlawful dismissal; separation pay, in contrast, is oriented towards the immediate future, the transitional period the dismissed employee must undergo before locating a replacement job.'

Reinstatement then of the petitioner would have been proper. However, since he reached the mandatory retirement age on 21 July 1991, reinstatement is no longer feasible. He should thus be awarded his backwages from 16 August 1988 to 21 July 1991, inclusive of allowances and the monetary equivalent of the other benefits due him for that period, plus retirement benefits under the PRC's compulsory retirement scheme which he would have been entitled to had he not been illegally dismissed." **(Escareal vs. National Labor Relations Commission, G.R. No. 99359, September 2, 1992, 213 SCRA 473, Underscoring supplied.)**

A distinction has been made between backwages and separation pay. Separation pay is defined as the amount that an employee receives at the time of his severance from the service and is designed to provide the employee with the wherewithal during the period that he is looking for another employment. It is computed at least one month salary or at the rate of one-half month salary for every year of service, whichever is higher. (Aquino vs. NLRC, G.R. No. 87653, February 11, 1992, 206 SCRA 118; Santos vs. NLRC, L-76721, September 21, 1987, 154 SCRA 166, 172) It is payable to an employee whose services are validly terminated as a result of retrenchment, closure of business or disease under Arts. 283 and 284 of the Labor Code (A'Prime Security Services, Inc. vs. NLRC, G.R. No. 93476, March 19, 1993, 220 SCRA 142).

Articles 283 and 284 of the Labor Code of the Philippines provide as follows:

> "ART. 283. **Closure of establishment and reduction of personnel.** - The employer may also terminate the employment of any employee due to the installation of labor savings devices, redundancy, retrenchment to prevent losses or the closing or cessation of operation of the establishment or undertaking unless the closing is for the purpose of circumventing the provisions of this Title, by serving a written notice on the workers and the Ministry of Labor and Employment at least one (1) month before the intended date thereof. In case of termination due to the installation of labor saving devices or redundancy, the worker affected thereby shall be entitled to a separation pay equivalent to at least his one (1) month pay or to at least one (1) month pay for every year of service, whichever is higher. In case of retrenchment to prevent losses and in cases of closures or cessation of operations of establishment or undertaking not due to serious business losses or financial reverses, the separation pay shall be equivalent to one (1) month pay or at least one-half (1/2) month pay for every year of service, whichever is

higher. A fraction of at least six (6) months shall be considered one (1) whole year.

ART. 284. **Disease as ground for termination.** - An employer may terminate the services of an employee who has been found to be suffering from any disease and whose continued employment is prohibited by law or is prejudicial to his health as well as to the health of his co-employees: Provided, That he is paid separation pay equivalent to at least one (1) month salary or to one-half (1/2) month salary for every year of service, whichever is greater, a fraction of at least six (6) months being considered as one (1) whole year."

An award of backwages, on the other hand, is a remedy intended to relieve the employee from the loss of earnings that would have accrued to him during the period between dismissal and reinstatement if viable or payment of separation pay if no longer viable. It is a form of relief that restores the income of the employee that was lost by reason of unlawful dismissal. (Santos vs. NLRC, *supra.*) The grant of reinstatement carries with it the award of backwages.

As pointed by the Supreme Court, petitioner would have been reinstated from the service by reason of his illegal dismissal. However, since petitioner is considered retired as of July 21, 1991, reinstatement cannot therefore be had. Instead, petitioner was awarded the retirement benefits due him for reaching the compulsory age of retirement on July 21, 1991. And since petitioner's termination from the service was illegal, it was as if there was no severance from the service because he was paid backwages up to the time of his compulsory retirement. There being no actual separation until after reaching the compulsory age of retirement, Section 28(b)(7)(B) of the Tax Code does not apply. In other words, the separation contemplated under Section 28(b)(7)(B) is a valid severance from the service beyond the control of the employee.

Furthermore, Sec. 2 of Rev. Regs. No. 6-82, as amended, speaks of the separation from the service of an employee for reasons beyond his control such as retrenchment and redundancy and cessation of business. There being no redundancy, for the case presented before us covers illegal dismissal, the exemption under Sec. 28(b)(7)(B) does not apply. Moreover, if the payment is in lieu of wages, it is not excludable from gross income. The backwages and bonuses received by petitioner for the period August 16, 1988 to July 21, 1991 are, therefore, subject to the withholding tax on income.

The question of whether or not petitioner is entitled to interest at the rate of 6% from the time of withholding until final refund of the amount of P179,572.00 has become moot, considering that petitioner's claim for refund cannot be granted by this Court.

WHEREFORE, the instant petition for review is hereby dismissed for lack of merit. Respondent's decision dated January 19, 1995 is hereby affirmed.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

I CONCUR:

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals