Atty. Septfonette Fe D. Balusdan

TAX LAW FOR BUSINESS

BDB Law's "Tax Law for Business" *appears in the opinion section of* ***Business Mirror*** *every Thursday.*

Withholding on retirement benefits

The responsibility to withhold tax on retirement benefits depends on whether the retirement benefit is considered taxable, which shall be determined by the law used in granting such benefit. Under the Tax Code, as amended, a retirement benefit is considered part of the compensation income of the income earner, since it is paid by reason of an employer-employee relationship. However, a retirement benefit is one of the exclusions from gross income, and thus, exempt from income tax. The taxability of retirement benefits is covered by Republic Act 4917 and RA 7641.

RA 4917 provides that retirement benefits of employees of private firms shall not be subject to attachment, levy, execution or any tax whatsoever. This applies when the employer has a Reasonable Private Benefit Plan (RPBP). On the other hand, RA 7641 amended Section 287 of the Labor Code; which provides for a retirement pay to qualified private-sector employees in the absence of any retirement plan. In order for a retirement benefit to be qualified as nontaxable, the conditions under RA 4917 and RA 7641, whichever is applicable, should be met.

Under RA 4917, a retirement benefit shall be nontaxable if the employee has been in the service of the same employer for at least 10 years, is not less than 50 years old, and that such benefit is availed only once. On the other hand, a retirement benefit shall be nontaxable under RA 7641 if there is a Collective Bargaining Agreement granting retirement benefits to the employees; or, if there is no CBA, the employee must have rendered at least five years of service, and that he/she must be at least 60 years old.

Based merely on the forgoing conditions, an employee covered under a Bureau of Internal Revenue-approved retirement plan would be subject to tax but not if he is not covered under a retirement plan or if the retirement plan is not a BIR-approved plan. Thus, to avoid this absurd situation, the BIR issued BIR Ruling (DA-151-04) in 2004, reconciling the rules on retirement benefits obtained under a retirement plan (governed by RA 4917) vis-a-vis the retirement benefits obtained without a retirement plan (governed by RA 7641).

The 2004 ruling provided the following rules: (1) If the retirement benefits received under a BIR-approved retirement plan covered by RA 4917 is equal to or less than the minimum retirement benefit provided by RA 7641, said benefits shall be exempt from income tax to prevent an absurd situation where the retirement benefits will be exempt if an employer does not have such a retirement plan or if the retirement plan is not approved by the BIR. (2) If the retirement benefits received under a BIR-approved retirement plan covered by RA 4917 exceed the minimum retirement benefit provided by RA 7641, the employee must comply with the conditions of RA 4917 in order that his retirement benefits may be tax-exempt.

BIR Ruling 234-13 emphasized that the age and length of service requirements under the Tax Code must be complied with to avail of the tax exemption on the retirement benefits. Based on this 2013 issuance, it appears that the age and length of service requirements imposed under the Tax Code are deemed by the BIR as minimum requirements for retirement benefits to qualify for income-tax exemption. Based on these prevailing laws and jurisprudence, there must be strict compliance with the minimum conditions under the Tax Code to avail the income-tax exemptions on retirement benefits.

Therefore, if the conditions above are met, the retirement benefit is exempt from income tax. However, if said conditions for the income-tax exemption are not met, the retirement benefit is taxable; and since the employer is constituted by law to be a withholding agent, it is charged to withhold and remit to the BIR the withholding taxes on its employees' retirement benefits. Thus, knowing the conditions for the nontaxability of retirement benefits is actually the responsibility of the employer, since said employer shall be the one to suffer the consequences of non-withholding and non-remittance in case the retirement benefit is released to the employee without first withholding the tax. “Know when to properly withhold, and when not to withhold.”

****

The author is a junior associate of Du-Baladad and Associates Law Offices (BDB Law), a member-firm of WTS Global.

The article is for general information only and is not intended, nor should be construed as a substitute for tax, legal or financial advice on any specific matter. Applicability of this article to any actual or particular tax or legal issue should be supported, therefore, by a professional study or advice. If you have any comments or questions concerning the article, you may e-mail the author at septfonettefe.balusdan@bdblaw.com.ph *or call 403-2001, local 170.*