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Treatment of Retirement Benefits Expense for Financial Reporting and Tax Purposes

OVERVIEW OF PFRS AND TAX TREATMENT

Particulars	PFRS	Tax Treatment	
		R.A. No. 4917[1]	R.A. 7641
Employee benefit expense	Employee benefit expense comprise of: ☑ Service costs ☑ Net interest costs	Contribution to a tax qualified plan is deductible expense	Actual retirement benefits paid is a deductible expense
Current service cost	Recognized in profit or loss as part of employee benefit expense	Contribution for normal cost is deductible in full	Not applicable
Past service cost	Recognized in profit or loss as part of employee benefit expense	Contribution for past service liability is recognized as deductible expense over ten years	Not applicable
Gain or loss on settlement	Recognized in profit or loss as part of employee benefit expense	Not applicable	
Return on plan assets	Included in the employee benefit costs	Exempt from income tax	Not applicable

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Particulars	PFRS	Tax Treatment	
		R.A. No. 4917[2]	R.A. 7641
Remeasurement gains and losses	Remeasurement gains and losses are recognized in other comprehensive income	Not applicable	
Actuarial valuation method	Actuarial valuation for accounting	Actuarial valuation for funding	Not applicable

DETAILED PFRS TREATMENT

Accounting for post-employment benefit depends on its classification:

	Defined Contribution (DC) Plan	Defined Benefit (DB) Plan
Nature	An entity pays fixed contributions into a separate entity (a fund) and will have no obligation to pay further contributions if the fund is insufficient to pay all employee benefits.	Any post-employment benefit plan other than a defined contribution plan
Accounting	Recognize contribution payable to a DC plan in exchange for that service as an expense unless another Standard requires it to be included in the cost of an asset	Requires a valuation prepared by an actuary using a projected unit credit method; A periodic journal entry to accrue retirement benefit liability is recorded as follows: Dr. Employee benefit cost Cr. Accrued employee benefits

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Employee benefit cost can be broken down into:

	Employee benefit expense	Remeasurement gains and losses
Composition	Service costs: • Current service cost – increase in the present value (PV) of the DB obligation resulting from employee service in the current period; • Past service cost – change in the PV of the DB obligation resulting from a plan amendment or curtailment; and • Settlement gain/loss – when there are differences between the PV of the DB obligation being settled and the settlement price Net interest costs – increase in the net DB liability/asset due to passage of time	Actuarial gains an losses; Difference between the actual return on plan assets and the interest income; and Effect of the asset ceiling
Recognition	Recognized in profit or loss unless another Standard requires it to be included as cost of an asset	Generally recognized as "Other Comprehensive Income"

DETAILED TAX TREATMENT

As to retirement benefits expense

- If the retirement benefit plan meets the requirements of a tax qualified plan under RA No. 4917 and evidenced by a BIR certificate of tax qualification, the following may be deducted to the retirement fund:
  - Contributions to the retirement fund during the taxable year to cover pension liability accrued during the year (Normal Cost);

- Contributions in excess of the Normal Cost, but only if it:
  - has not up to that time been allowed as a deduction; and
  - is apportioned in equal parts over a period of 10 consecutive years beginning with the year in which the transfer or payment is made.

Any other amount of contributions shall not be allowed as deduction from gross income. Also, any amount reverted to the employer shall be reported as income.

- If there is no tax qualified plan, RA No. 7641 shall apply and only the actual amount of retirement benefits paid to employees can be claimed as deduction from gross income.

As to tax exemption of the employee retirement benefit plan

- An application for the issuance of a Certificate of Qualification as a Reasonable Employee's Retirement Benefit Plan (Certificate of Qualification) shall be filed with the Legal and Legislative Division within 30 days from the date of effectivity of the retirement benefit plan. The certificate shall be valid until revoked.

- During the pendency of the application, the tax implications are as follows:

Particulars	Tax Implications
Retirement benefit of those who attained the age of 50 and rendered at least 10 years of service	Exempt from income tax (IT) and withholding tax (WT) and the effectivity of the approval shall retroact to the date of the retirement benefit plan
Investment income of the retirement fund	Exempt from IT
Tax-deductibility of contributions	Deductible from gross income

However, should the application be denied, the employer shall be **directly and solely** liable for the deficiency IT on the retirement benefits, investment income, and disallowed deductions.

As to investing the employee retirement fund

- The income of a retirement fund from investments are exempt from income tax provided that:
  - all statutory requirements for a reasonable retirement benefit plan under Section 60(B) of the Tax Code, as amended, are met; and
  - the funds are not actually used or diverted to purposes other than for the exclusive benefit of the employees or beneficiaries.

- Income tax exemption under Section 60(B) of the Tax Code, as amended, may be denied if the trust is engaged in any of the acts enumerated under Section 5 of RR No. 1-68.

- The fund manager should not use the retirement fund to invest/deposit in any of the employer's business ventures.

As to calculation of service/retirement costs

- Retirement cost for financial reporting is based on requirements of PAS19/PFRS which uses published discount rates for the projected unit method or the accrual method.

- Retirement cost deductible for tax purposes is based on actuarial valuation for funding requirements that uses the expected return on the fund's actual investments in determining normal costs and past service liability.

As to retirement benefits received

- Retirement benefits received under RA No. 4917 is exempt from income tax and withholding tax provided that the retiring employee:
  - Must be at least 50 years of age and has served the employer for at least 10 years; and
  - Has not previously availed of the privilege under a retirement benefit plan of the same or another employer.

- In relation to retirement benefits under RA No. 4917, the 10-year requirement would be computed only in one company following Section 32(B)(6)(a) of the Tax Code, as amended. As an exception, the 10-year requirement is computed on an aggregate basis in case of transfer of employees from one participating company to another within a multi-employer plan due to a valid merger.

- Retirement benefits received under RA No. 7641 is exempt from income tax and withholding tax provided that the retiring employee:
  - Must be at least 60 years of age but not beyond 65 years of age;
  - Has served the employer for at least 5 years; and
  - Has not previously availed of the privilege under a retirement benefit plan of the same or another employer.

- In relation to retirement benefits under RA No. 7641, the exemption shall also apply if the employment continues beyond the compulsory retirement age as long as the other factors are present. This is because there is no prohibition on the continuation of the employment.

<u>As to changes to the Plan Rules other than benefits/eligibilities</u>

- Any amendment to the approved corporate retirement plan should be submitted to the BIR for certification.

- Prescribed fees should also be paid to the BIR.

Source:
BIR Revenue Memorandum Circular No. 13-2024