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EN BANC

[Adm. Matter No. 90-6-015-SC. October 18, 1990]

RE: REQUEST OF ATTY. BERNARDO ZIALCITA FOR RECONSIDERATION OF THE ACTION OF THE FINANCIAL AND BUDGET OFFICE.

SYLLABUS

1. **TAXATION; INCOME TAXATION; THE MONEY VALUE OF ACCUMULATED LEAVE CREDITS IS EXEMPT FROM INCOME TAX.** — Atty. Zialcita opted to retire under the provisions of Republic Act 660, which is incorporated in Commonwealth Act No. 186. Section 12(c) of C.A. 186 states: "x x x Officials and employees retired under this Act shall be entitled to the commutation of the unused vacation leave and sick leave, based on the highest rate received, which they may have to their credit at the time of retirement." Section 28(c) of the same Act, in turn, provides: "(c) Except as herein otherwise provided, the Government Service Insurance System, *all benefits granted under this Act,* and all its forms and documents required of the members shall be *exempt from all types of taxes,* documentary stamps, duties and contributions, fiscal or municipal, direct or indirect, established or to be established; x x x." Applying the two aforesaid provisions, it can be concluded that the amount received by Atty. Zialcita as a result of the conversion of these unused leaves into cash is exempt from income tax.

2. **POLITICAL LAW; ADMINISTRATIVE LAW; PUBLIC OFFICERS AND EMPLOYEES; TERMINAL LEAVE; NATURE.** — The commutation of leave credits is commonly known as *terminal leave.* 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. Since terminal leave is applied for by an officer or employee who has already severed his connection with his employer and who is no longer working, then it follows that the terminal leave pay, which is the cash value of his accumulated leave credits, is no longer compensation for services rendered. It can not be viewed as salary.

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3. TAXATION; INCOME TAXATION; TERMINAL LEAVE PAY; AN EXCLUSION FROM GROSS INCOME AND IS NOT SUBJECT TO TAX. — Executive Order No. 1077, Section 1, provides: "Any officer or employee of the government who *retires* or voluntarily resigns or is separated from the service *through no fault of his own* and whose leave benefits are not covered by special law, shall be entitled to the commutation of all the accumulated vacation and/or sick leaves to his credit, exclusive of Saturdays, Sundays and holidays, without limitation as to the number of days of vacation and sick leaves that he may accumulate." Meanwhile, Section 28 (b) 7 (b) of the National Internal Revenue Code (NIRC) states: "Sec. 28 (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 (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 separation 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 the said official or employee." In the case of Atty. Zialcita, he rendered government service from March 13, 1962 up to February 15, 1990. The next day, or on February 16, 1990, he reached the compulsory retirement age of 65 years. Upon his compulsory retirement, he is entitled to the commutation of his accumulated leave credits to its money value. Within the purview of the above-mentioned provisions of the NIRC, compulsory retirement may be considered as a "*cause beyond the control of the said official or employee.*" Consequently, the amount that he received by way of commutation of his accumulated leave credits as a result of his compulsory retirement, or his terminal leave pay, falls within the enumerated exclusions from gross income and is therefore not subject to tax.

4. POLITICAL LAW; ADMINISTRATIVE LAW; PUBLIC OFFICERS AND EMPLOYEES; TERMINAL LEAVE; VIEWED AS A RETIREMENT GRATUITY RECEIVED BY GOVERNMENT OFFICIALS AND EMPLOYEES. — The terminal leave pay of Atty. Zialcita may likewise be viewed as a "retirement gratuity received by government officials and employees" which is also another exclusion from gross income as provided for in Section 28(b), 7(f) of the NIRC. A gratuity is that paid to the beneficiary for past services rendered purely

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out of generosity of the giver or grantor. It is a mere bounty given by the government in consideration or in recognition of meritorious services and springs from the appreciation and graciousness of the government. When a government employee chooses to go to work rather than absent himself and consume his leave credits, there is no doubt that the government is thereby benefited by the employee's uninterrupted and continuous service. It is in cognizance of this fact that laws were passed entitling retiring government employees, among others, to the commutation of their accumulated leave credits. That which is given to him after retirement is out of the Government's generosity and an appreciation for his having continued working when he could very well have gone on vacation. Section 286 of Revised Administrative Code, as amended by R.A. 1081, provides that "whenever any officer, employee or laborer of the Government of the Philippines shall voluntarily resign or be *separated* from the service *through no fault of his own*, he shall be *entitled to the commutation of all accumulated vacation and/or sick leave to his credit*: x x x." Executive Order No. 1077, mentioned above, later amended Section 286 by removing the limitation on the number of leave days that may be accumulated and explicitly allowing *retiring* government employees to commute their accumulated leaves. The commutation of accumulated leave credits may thus be considered a retirement gratuity, within the import of Section 28(b), 7(f) of the NIRC, since it is given only upon retirement and in consideration of the retiree's meritorious services. It is clear that the law expresses the government's appreciation for many years of service already rendered and the clear intention to reward faithful and often underpaid workers after the official relationship had been terminated.

5. ID.; ID.; ID.; ID.; SALARY; AN EMPLOYEE IS TAXED ON THE ENTIRETY OF HIS SALARIES WITHOUT ANY DEDUCTIONS FOR ANY LEAVE NOT UTILIZED. — Section 284 of the Revised Administrative Code grants to a government employee 15 days vacation leave and 15 days sick leave for every year of service. Hence, even if the government employee absents himself and exhausts his leave credits, he is still *deemed* to have worked and to have rendered services. His leave benefits are already imputed in, and form part of, his salary which in turn is subjected to withholding tax on income. He is taxed on the entirety of his salaries without any deductions

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for any leaves not utilized. It follows then that the money values corresponding to these leave benefits both the used and unused have already been taxed during the year that they were earned. To tax them again when the retiring employee receives their money value as a form of government concern and appreciation plainly constitutes an attempt to tax the employee a second time. This is tantamount to double taxation.

6. **TAXATION; TAX REFUND; FORMAL REQUEST FOR REFUND; APPLICABILITY.** — With respect to the need for a written request for refund, we rule that Atty. Zialcita need no longer file a formal request for refund since the August 23, 1990 Resolution, which principally deals with his case, already binds the intervenor-movant Commissioner of Internal Revenue. However, with respect to other retirees allegedly similarly situated and from whom withholding taxes on terminal leave pay have been deducted, we rule that these retirees should file a written request for refund within two years from the date of promulgation of this resolution. Fiscal considerations do not allow that this matter be left hanging for an indefinite period while retirees make up their minds as to whether or not they are entitled to refunds.

7. **ID.; DOUBLE TAXATION; TAXING TERMINAL LEAVE PAY *CONSTITUTES DOUBLE TAXATION.*** — *The Chief of the* Finance Division of this Court likewise seeks clarification with respect to the applicability of our August 23, 1990 Resolution to the following employees of this Court: a) those who avail of optional retirement; and b) those who resign or are separated from the service through no fault of their own. The two groups mentioned above are also entitled to terminal leave pay in accordance with Section 286 of the Revised Administrative Code, as amended by R.A. 1081. In the light of our ruling that to tax terminal leave pay would result in the taxation of benefits given after and as direct consequences of retirement and would, in effect, constitute double taxation, we rule that this resolution also applies to those who avail of optional retirement and to those who resign or are separated from the service through no fault of their own.

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Re: Request of Atty. Zialcita for Reconsideration of the Action of the Financial and Budget Office

RESOLUTION

GUTIERREZ, JR., *J.*:

On August 23, 1990, a resolution of the Court *En Banc* was issued regarding the amounts claimed by Atty. Bernardo F. Zialcita on the occasion of his retirement. The resolution states, among others:

"The terminal leave pay of Atty. Zialcita received by virtue of his compulsory retirement can never be considered a 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. No. 220 and is thus exempt from the payment of income tax. That the money value of his accrued leave credits is not a part of his salary is further buttressed by Sec. 3 of P.D. No. 985, otherwise known as 'The Budgetary Reform Decree on Compensation and Position Classification of 1976' particularly Sec. 3 (a) thereof, which makes it clear that the actual service is the period of time *for which pay has been received, excluding the period covered by terminal leave.*"

The dispositive portion provides:

"Accordingly, the Court Resolved to (1) ORDER the Fiscal Management and Budget Office to REFUND Atty. Zialcita the amount of ₱59,502.33 which was deducted from his terminal leave pay as withholding tax; and (2) DECLARE that henceforth no withholding tax shall be deducted by *any Office of this Court* from the terminal leave pay benefits of all retirees similarly situated including those who have already retired and from whose retirement benefits such withholding taxes were deducted. Sarmiento, *J.*, is on leave."

On September 18, 1990, the Commissioner of Internal Revenue, as intervenor-movant and through the Solicitor General filed a motion for clarification and/or reconsideration with this Court.

After careful deliberation, the Court resolved to deny the motion for reconsideration and hereby holds that the money value of the accumulated leave credits of Atty. Bernardo Zialcita are not taxable for the following reasons:

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1) Atty. Zialcita opted to retire under the provisions of Republic Act 660, which is incorporated in Commonwealth Act No. 186. Section 12(c) of C.A. 186 states:

"x x x Officials and employees retired under this Act shall be entitled to the commutation of the unused vacation leave and sick leave, based on the highest rate received, which they may have to their credit at the time of retirement."

Section 28(c) of the same Act, in turn, provides:

"(c) Except as herein otherwise provided, the Government Service Insurance System, *all benefits granted under this Act*, and all its forms and documents required of the members shall be *exempt from all types of taxes*, documentary stamps, duties and contributions, fiscal or municipal, direct or indirect, established or to be established; x x x." (Italics supplied)

Applying the two aforesaid provisions, it can be concluded that the amount received by Atty. Zialcita as a result of the conversion of these unused leaves into cash is exempt from income tax.

2) The commutation of leave credits is commonly known as *terminal leave*. (Manual on Leave Administration Course for Effectiveness, published by the Civil Service Commission, p. 17) 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. (*supra*, p. 16) Since terminal leave is applied for by an officer or employee who has already severed his connection with his employer and who is no longer working, then it follows that the terminal leave pay, which is the cash value of his accumulated leave credits, is no longer compensation for services rendered. It can not be viewed as salary.

3) Executive Order No. 1077, Section 1, provides:

"Any officer or employee of the government who *retires* or voluntarily resigns or is separated from the service *through no fault of his own* and whose leave benefits are not covered by special law, shall be entitled to the commutation of all the accumulated vacation and/or sick leaves to his credit, exclusive of Saturdays, Sundays and

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holidays, without limitation as to the number of days of vacation and sick leaves that he may accumulate." (Italics supplied)

Meanwhile, Section 28 (b), 7 (b) of the National Internal Revenue Code (NIRC) states:

"Sec. 28 (b) — Exclusions from gross income — The following items shall not be included in gross income and shall be exempt from taxation under this Title:

xxx xxx xxx

(7) Retirement benefits, pensions, gratuities, *etc.*

xxx xxx xxx

(b) 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 cause beyond the control* of the said official or employee." *(Italics supplied)*

In the case of Atty. Zialcita, he rendered government service from March 13, 1962 up to February 15, 1990. The next day, or on February 16, 1990, he reached the compulsory retirement age of 65 years. Upon his compulsory retirement, he is entitled to the commutation of his accumulated leave credits to its money value. Within the purview of the above-mentioned provisions of the NIRC, compulsory retirement may be considered as a "*cause beyond the control of the said official or employee.*" Consequently, the amount that he received by way of commutation of his accumulated leave credits as a result of his compulsory retirement, or his terminal leave pay, falls within the enumerated exclusions from gross income and is therefore not subject to tax.

4. The terminal leave pay of Atty. Zialcita may likewise be viewed as a "retirement gratuity received by government officials and employees" which is also another exclusion from gross income as provided for in Section 28(b), 7(f) of the NIRC. A gratuity is that paid to the beneficiary for past services rendered purely out of generosity of the giver or grantor. (*Peralta v. Auditor General*, 100 Phil. 1051 [1957]) It is a mere bounty

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given by the government in consideration or in recognition of meritorious services and springs from the appreciation and graciousness of the government. (*Pirovano v. De la Rama Steamship Co.*, 96 Phil. 335, 357 [1954]) When a government employee chooses to go to work rather than absent himself and consume his leave credits, there is no doubt that the government is thereby benefited by the employee's uninterrupted and continuous service. It is in cognizance of this fact that laws were passed entitling retiring government employees, among others, to the commutation of their accumulated leave credits. That which is given to him after retirement is out of the Government's generosity and an appreciation for his having continued working when he could very well have gone on vacation. Section 286 of Revised Administrative Code, as amended by R.A. 1081, provides that "whenever any officer, employee or laborer of the Government of the Philippines shall voluntarily resign or be *separated* from the service *through no fault of his own*, he shall be *entitled to the commutation of all accumulated vacation and/or sick leave to his credit:* x x x." (Italics supplied) Executive Order No. 1077, mentioned above, later amended Section 286 by removing the limitation on the number of leave days that may be accumulated and explicitly allowing *retiring* government employees to commute their accumulated leaves. The commutation of accumulated leave credits may thus be considered a retirement gratuity, within the import of Section 28(b), 7(f) of the NIRC, since it is given only upon retirement and in consideration of the retiree's meritorious services.

It is clear that the law expresses the government's appreciation for many years of service already rendered and the clear intention to reward faithful and often underpaid workers after the official relationship had been terminated.

5) Section 284 of the Revised Administrative Code grants to a government employee 15 days vacation leave and 15 days sick leave for every year of service. Hence, even if the government employee absents himself and exhausts his leave credits, he is still *deemed* to have worked and to have rendered services. His leave benefits are already imputed in, and form part of, his

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salary which in turn is subjected to withholding tax on income. He is taxed on the entirety of his salaries without any deductions for any leaves not utilized. It follows then that the money values corresponding to these leave benefits both the used and unused have already been taxed during the year that they were earned. To tax them again when the retiring employee receives their money value as a form of government concern and appreciation plainly constitutes an attempt to tax the employee a second time. This is tantamount to double taxation.

The Commissioner of Internal Revenue seeks, in the alternative, to be clarified with respect to the following:

a. the applicability of the August 23, 1990 Resolution to *other* government officials and employees; and

b. to those who have already retired and from whose retirement benefits withholding taxes have been deducted, whether or not the deducted taxes are refundable even without a written request for refund from the taxpayer-retiree.

The case of Atty. Bernardo Zialcita (entitled Administrative Matter No. 90-6-015-SC) is merely an administrative matter involving an employee of this Court who applied for retirement benefits and who questioned the deductions on the benefits given to him. Hence, our resolution applies only to employees of the Judiciary. If we extend the effects of the aforementioned resolution to all other government employees, in the absence of an actual case and controversy, we would in principle be rendering an advisory opinion. We cannot foresee at this time and for all cases all factors bearing upon the rights of government workers of varying categories from diverse offices. The authorities concerned will have to determine and rule on each case as it arises. "Similarly situated" is a most ambiguous and undefined term whose application cannot be fixed in advance.

With respect to the need for a written request for refund, we rule that Atty. Zialcita need no longer file a formal request for refund since the August 23, 1990 Resolution, which principally deals with his case, already binds the intervenor-movant Commissioner of Internal Revenue. However, with respect to

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other retirees allegedly similarly situated and from whom withholding taxes on terminal leave pay have been deducted, we rule that these retirees should file a written request for refund within two years from the date of promulgation of this resolution. Fiscal considerations do not allow that this matter be left hanging for an indefinite period while retirees make up their minds as to whether or not they are entitled to refunds.

The Chief of the Finance Division of this Court likewise seeks clarification with respect to the applicability of our August 2, 1990 Resolution to the following employees of this Court:

a) those who avail of optional retirement; and

b) those who resign or are separated from the service through no fault of their own.

The two groups mentioned above are also entitled to terminal leave pay in accordance with Section 286 of the Revised Administrative Code, as amended by R.A. 1081. In the light of our ruling that to tax terminal leave pay would result in the taxation of benefits given after and as direct consequences of retirement and would, in effect, constitute double taxation, we rule that this resolution also applies to those who avail of optional retirement and to those who resign or are separated from the service through no fault of their own.

The Court understands the urgent need of Government to tap all possible sources of revenue because of its heavy expenditures and the failure of actual income to cover all disbursements. However, the solution is not the levying of taxes on benefits and gratuities which by law are not supposed to be taxed. The remedy is to either amend the retirement law subject, of course, to constitutional constraints or to institute vastly improved and effective tax collection efforts.

All salaried workers and wage earners, whether in the public or the private sector, are taxed to the last centavo of their incomes throughout the entirety of their working lives. The same cannot be said of factory workers, leaders of industry, merchants, self-employed professionals, movie stars, fishing magnates, bus and jeepney operators, vice lords, theatre owners,

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and real estate lessors, to name only a few. A middle or lower echelon employee who retires after thirty or forty years of service helplessly sees his retirement pensions or benefits unavoidably and rapidly decrease in value in only a few years even as his cost of living, age, health, and other personal circumstances call for increased expenditures. We fail to see the logic in viewing with eager eyes for purposes of tax revenues the fruits of a working lifetime of labor simply because fixed salaries and retirement benefits are so visible and so convenient to levy upon. Retirees who are most deserving of compassion and who can least carry the multifarious burdens of Government should not be so readily encumbered on a strained interpretation of the law.

WHEREFORE, the Court Resolved to (1) DENY with FINALITY the motion for reconsideration of the intervenor-movant and the Solicitor General; and (2) DECLARE (a) that the August 23, 1990 Resolution on A.M. No. 90-6-015-SC specifically applies only to employees and officers of the Judiciary who retire, resign or are separated through no fault of their own; and (b) that retirees and former employees of the Judiciary; except Atty. Zialcita, from whose terminal leave pay withholding taxes have been deducted, must file a written claim for refund with the Commissioner of Internal Revenue within two years from the date of promulgation of this resolution.

SO ORDERED.

Fernan, C.J., Narvasa, Melencio-Herrera, Cruz, Paras, Gancayco, Padilla, Bidin, Sarmiento, Cortés, Griño-Aquino, Medialdea, and *Regalado, JJ.*, concur.

Feliciano, J., on leave.