



TAX LAW FOR BUSINESS
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Withholding tax on backwages

LAST year the Bureau of Internal Revenue (BIR) released Revenue Regulation (RR) 05-11, specifically enumerating items that are subject to "de minimis benefits." The said regulation expressly and formally disallowed all other benefits given by employers that are not included in the said enumeration to be considered as "de minimis" benefits. Hence, those shall be subject to income tax, as well as withholding tax, on compensation income.

This prompted the employers to restudy the compensation package they currently offer to their employees to ensure that with the current employment benefits, there will be no exposure to tax deficiency by virtue of RR 05-11.

Just recently, the BIR issued Revenue Memorandum Circular (RMC) 39-2012 requiring the withholding of taxes on backwages, allowances and benefits received by disgruntled employees by virtue of a labor dispute award through garnishments of debts due to the employers and other credits to which the employer is entitled. This "other credits" include bank deposits, financial interest, royalties or commissions.

With this RMC, the BIR wants to ensure the collection of the appropriate withholding taxes on wages through the withholding-tax system scheme. Accordingly, the garnishees of a judgment award in a labor dispute are constituted as withholding agent by the BIR with the duty of deducting the corresponding withholding tax on the backwages due in an amount equivalent to 5 percent of the portion of the judgment award representing the taxable backwages, allowances and benefits.

Notably under the RR is the imposition of the 5-percent withholding-tax rate of the portion of the award. The withholding-tax rate is quite contrary to the usual withholding-tax rate on compensation that falls within the range of 20 percent to 25 percent. Considering the fact that the legal basis of the withholding tax on wages on awards are Section 78(D) of the Tax Code as amended and Section 2.78.4(A) of RR 2-98, which basically pertained to the withholding tax on compensation, it is quite confusing that the BIR proposed a different withholding-tax rate other than the usual. Whether this 5 percent is the final settlement of the tax liabilities of the employee receiving the backwages is not certain. What is clear is that the 5-percent withholding tax is a tax on the backwages. It could also be that the reduced tax is a way of the BIR in understanding the situation of a disgruntled employee.

It is, indeed, a fact that the government generates substantial revenues from the salaried individuals. To further intensify its collection campaign from the employed sector, the BIR issues regulations every so often to ensure the collection of revenues from employed individual. Collections from self-employed individuals are not as substantial as those employed according to BIR data. But according to Finance Secretary Purisima, they are now focusing on improving the tax- compliance level of this sector that includes professionals, sole proprietors and small businesses.

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