

Title: Commissioner of Internal Revenue vs. The Court of Appeals and Efren P. Castaneda

Facts:

Efren P. Castaneda, upon his compulsory retirement as Revenue Attache in the Philippine Embassy in London on December 10, 1982, received terminal leave pay among other benefits. The Commissioner of Internal Revenue withheld P12,557.13 from Castaneda's terminal leave pay as income tax. Castaneda contested this, asserting that his terminal leave pay was exempt from income tax, and sought a refund for the withheld amount. To adhere to the two-year prescriptive period for tax refund claims, Castaneda filed a Petition for Review with the Court of Tax Appeals on July 16, 1984. The Court of Tax Appeals ruled in favor of Castaneda, ordering the Commissioner to refund the withheld amount. Dissatisfied, the Commissioner appealed to the Supreme Court, which then referred the case to the Court of Appeals as CA-G.R. SP No. 20482. The Court of Appeals upheld the Tax Court's decision, prompting the Commissioner's further appeal to the Supreme Court.

Issues:

1. Is terminal leave pay received by a government official upon compulsory retirement subject to income tax?
2. Does terminal leave pay constitute part of gross income or compensation for services rendered?

Court's Decision:

The Supreme Court resolved the issues in the negative, thereby affirming the decisions of the lower courts. It held that terminal leave pay is not subject to withholding income tax. The Court differentiated terminal leave pay from gross salary or income, categorizing it as a retirement benefit rather than compensation for services rendered. It reinforced its ruling by citing the rationale from the case of *Jesus N. Borrromeo vs. The Hon. Civil Service Commission, et al.*, marking terminal leave pay as a modest nest egg intended to support government officials or employees upon retirement, which, by policy considerations, should not be taxed.

Doctrine:

Terminal leave pay, being a retirement benefit and not part of the gross salary or income of a government official or employee, is not subject to income tax.

Class Notes:

- **Terminal Leave Pay**: It is compensation for accumulated leave credits, payable upon retirement or separation from service.
- **Gross Income**: Refers to all income derived from whatever source, including compensations for services rendered, but does not include retirement benefits like terminal leave pay.
- **Income Tax**: Tax imposed on income by the government. Retirement benefits are generally exempt from this tax under specific provisions.
- **Tax Refund**: A taxpayer's right when overpayment of tax has been made. There is a prescriptive period within which claims for refund may be filed, typically within two years from the date of payment.

Relevant Statutes:

- Commonwealth Act 186, Section 12(c): Governs the retirement benefits of government officials and employees.
- National Internal Revenue Code, Section 28: Defines gross income and its components for the purpose of taxing income.

Historical Background:

This case emphasizes the Philippine government's longstanding policy to support its retiring employees by exempting retirement benefits from income tax. It showcases the judiciary's role in interpreting tax laws to align with the intent of supporting retirees, ensuring they receive the full benefits of their retirement pay without the burden of taxation. This decision is part of a broader legal context where retirement benefits are protected to provide financial security to former public servants.