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THIRD DIVISION

[G.R. NO. 159991, November 16, 2006]

CARMELINO F. PANSACOLA, PETITIONER, VS. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

DECISION

QUISUMBING, J.:

For review on certiorari is the Decision[1] dated June 5, 2003 of the Court of Appeals in CA-G.R. S.P. No. 60475. The appellate court denied petitioner's availment of the increased amounts of personal and additional exemptions under Republic Act No. 8424, the National Internal Revenue Code of 1997[2] (NIRC), which took effect on January 1, 1998. Also assailed is the appellate court's Resolution[3] dated September 11, 2003, denying the motion for reconsideration.

The facts are undisputed.

On April 13, 1998, petitioner Carmelino F. Pansacola filed his income tax return for the taxable year 1997 that reflected an overpayment of P5,950. In it he claimed the increased amounts of personal and additional exemptions under Section 35[4] of the NIRC, although his certificate of income tax withheld on compensation indicated the lesser allowed amounts[5] on these exemptions. He claimed a refund of P5,950 with the Bureau of Internal Revenue, which was denied. Later, the Court of Tax Appeals also denied his claim because according to the tax court, "it would be absurd for the law to allow the deduction from a taxpayer's gross income earned on a certain year of exemptions availing on a different taxable year..."[6] Petitioner sought reconsideration, but the same was denied.[7]

On appeal, the Court of Appeals denied his petition for lack of merit. The appellate court ruled that *Umali v. Estanislao*,[8] relied upon by petitioner, was inapplicable to his case. It further ruled that the NIRC took effect on January 1, 1998, thus the increased exemptions were effective only to cover taxable year 1998 and cannot be applied retroactively.

Petitioner, before us, raises a single issue:

> ...[W]hether or not the increased personal and additional exemptions under [the NIRC] can be availed of by the [p]etitioner for purposes of computing his income tax liability for the taxable year 1997 and thus be entitled to the refund.[9]

Simply stated, the issue is: Could the exemptions under Section 35 of the NIRC, which took effect on January 1, 1998, be availed of for the taxable year 1997?

Petitioner argues that the personal and additional exemptions are of a fixed character based on Section 35 (A) and (B) of the NIRC[10] and as ruled by this Court in *Umali,* these personal and additional exemptions are fixed amounts to which an individual taxpayer is entitled. He contends that unlike other allowable deductions, the availability of these exemptions does not depend on the taxpayer's profession, trade or business for a particular taxable period. Relying again in *Umali,* petitioner alleges that the Court of Appeals erred in ruling that the increased exemptions were meant to be applied beginning taxable year 1998 and were to be reflected in the taxpayers' returns to be filed on or before April 15, 1999. Petitioner reasons that such ruling would postpone the availability of the increased exemptions and literally defer the effectivity of the NIRC to January 1, 1999. Petitioner insists that the increased exemptions were already available on April 15, 1998, the deadline for filing income tax returns for taxable year 1997, because the NIRC was already effective.

Respondent, through the Office of the Solicitor General, counters that the increased exemptions were not yet available for taxable year 1997 because all provisions of the NIRC took effect on January 1, 1998 only; that the fixed character of personal and additional exemptions does not necessarily mean that these were not time bound; and petitioner's proposition was contrary to Section 35 (C)[11] of the NIRC. It further stated that petitioner's exemptions were determined as of December 31, 1997 and the effectivity of the NIRC during the period of January 1 to April 15, 1998 did not affect his tax liabilities within the taxable year 1997; and the inclusive period from January 1 to April 15, 1998, the filing dates and deadline for administrative purposes, was outside of the taxable year 1997. Respondent also maintains that *Umali* is not applicable to this case.

Prefatorily, personal and additional exemptions under Section 35 of the NIRC are fixed amounts to which certain individual taxpayers (citizens, resident aliens)[12] are entitled. Personal exemptions are the theoretical personal, living and family expenses of an individual allowed to be deducted from the gross or net income of an individual taxpayer. These are arbitrary amounts which have been calculated by our lawmakers to be roughly equivalent to the minimum of subsistence,[13] taking into account the personal status and additional qualified dependents of the taxpayer. They are fixed amounts in the sense that the amounts have been predetermined by our lawmakers as provided under Section 35 (A) and (B). Unless and until our lawmakers make new adjustments on these personal exemptions, the amounts allowed to be deducted by a taxpayer are fixed as predetermined by Congress.

A careful scrutiny of the provisions[14] of the NIRC specifically shows that Section 79 (D)[15] provides that the personal and additional exemptions shall be determined in accordance with the main provisions in Title II of the NIRC. Its main provisions pertain to Section 35 (A) and (B) which state,

> SEC. 35. ***Allowance of Personal Exemption for Individual Taxpayer.*** -
>
> (A) *In General.*-***For purposes of determining the tax provided in Section 24(A) of this Title,***[16] there shall be allowed a basic personal exemption as follows:

x x x x

For each married individual – **P32,000**

x x x x

(B) *Additional Exemption for Dependents.*–There shall be allowed an additional exemption of Eight thousand pesos (**P8,000**) for each dependent not exceeding four (4). (Emphasis ours.)

Section 35 (A) and (B) allow the basic personal and additional exemptions as deductions from gross or net income, as the case maybe, to arrive at the correct taxable income of certain individual taxpayers. Section 24 (A) (1) (a) imposed income tax on a resident citizen's taxable income derived for each taxable year. It provides as follows:

SEC. 24. ***Income Tax Rates.*** –

(A) *Rates of Income Tax on Individual Citizen ...*

(1) An income tax is hereby imposed:

(a) ***On the taxable income defined in Section 31 of this Code,*** other than income subject to tax under Subsections (B),[17] (C),[18] and (D)[19] of this Section, ***derived for each taxable year*** from all sources within and without the Philippines by every individual citizen of the Philippines residing therein; (Emphasis ours.)

Section 31 defines "taxable income" as the pertinent items of gross income specified in the NIRC, less the deductions and/or personal and additional exemptions, if any, authorized for such types of income by the NIRC or other special laws. As defined in Section 22 (P),[20] "taxable year" means the calendar year, upon the basis of which the net income is computed under Title II of the NIRC. Section 43[21] also supports the rule that the taxable income of an individual shall be computed on the basis of the calendar year. In addition, Section 45[22] provides that the deductions provided for under Title II of the NIRC shall be taken for the taxable year in which they are "paid or accrued" or "paid or incurred."

Moreover, Section 79 (H)[23] requires the employer to determine, on or before the end of the calendar year but prior to the payment of the compensation for the last payroll period, the tax due from each employee's taxable compensation income for the entire taxable year in accordance with Section 24 (A). This is for the purpose of either withholding from the employee's December salary, or refunding to him not later than January 25 of the succeeding year, the difference between the tax due and the tax withheld.

Therefore, as provided in Section 24 (A) (1) (a) in relation to Sections 31 and 22 (P) and Sections 43, 45 and 79 (H) of the NIRC, the income subject to income tax is the taxpayer's income as derived and computed during the calendar year, his taxable year.

Clearly from the abovequoted provisions, what the law should consider for the purpose of determining the tax due from an individual taxpayer is his status and qualified dependents at the close of the taxable year and not at the time the return is filed and the tax due thereon is paid. Now comes Section 35 (C) of the NIRC which provides,

> Sec. 35. *Allowance of Personal Exemption for Individual Taxpayer.* –
>
> x x x x
>
> (C) *Change of Status*. – If the taxpayer marries or should have additional dependent(s) as defined above during the taxable year, the taxpayer may claim the corresponding additional exemption, as the case may be, in full for such year.
>
> If the taxpayer dies during the taxable year, his estate may still claim the personal and additional exemptions for himself and his dependent(s) as if he died at the close of such year.
>
> If the spouse or any of the dependents dies or if any of such dependents marries, becomes twenty-one (21) years old or becomes gainfully employed during the taxable year, the taxpayer may still claim the same exemptions as if the spouse or any of the dependents died, or as if such dependents married, became twenty-one (21) years old or became gainfully employed at the close of such year.

Emphasis must be made that Section 35 (C) of the NIRC allows a taxpayer to still claim the corresponding full amount of exemption for a taxable year, *e.g.* if he marries; have additional dependents; he, his spouse, or any of his dependents die; and if any of his dependents marry, turn 21 years old; or become gainfully employed. It is as if the changes in his or his dependents' status took place at the close of the taxable year.

Consequently, his correct taxable income and his corresponding allowable deductions *e.g.* personal and additional deductions, if any, had already been determined as of the end of the calendar year.

In the case of petitioner, the availability of the aforementioned deductions if he is thus entitled, would be reflected on his tax return filed on or before the 15th day of April 1999 as mandated by Section 51 (C) (1).[24] Since the NIRC took effect on January 1, 1998, the increased amounts of personal and additional exemptions under Section 35, can only be allowed as deductions from the individual taxpayer's gross or net income, as the case maybe, for the taxable year 1998 to be filed in 1999. The NIRC made no reference that the personal and additional exemptions shall apply on income earned before January 1, 1998.

Thus, petitioner's reliance in *Umali* is misplaced.

In *Umali,* we noted that despite being given authority by Section 29 (1) (4)[25] of the National Internal Revenue Code of 1977 to adjust these exemptions, no adjustments were made to cover 1989. Note that Rep. Act No. 7167 is entitled "*An Act Adjusting the Basic Personal and Additional Exemptions Allowable to Individuals*