

Tax break for voluntarily retrenched employees

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The South African Institute of Tax Professionals (Sait) recently made submissions to the South African Revenue Service (Sars) regarding the tax treatment of amounts received in consequence of voluntary retrenchments. Sait has received clarification that voluntary severance packages qualify as severance benefits.



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The submissions were made in response to the recently published Completion Guide for IRP3(a) and IRP3(s) Forms (Sars Completion Guide). The Sars Completion Guide assists employers in submitting tax directives on, amongst others, the retrenchment of employees. The Sars Completion Guide appears to adopt the view that only involuntary severance payments qualify for the preferential tax treatment of "severance benefits" and not voluntary severance packages. If an employee agrees to a voluntary severance package and the employer elects "severance benefits - voluntary retrenchment" in the IRP3(a) form, the application is currently processed by Sars according to the normal tax tables, and not the favourable tax table for severance benefits.

Voluntary and involuntary retrenchments are usually a result of a general reduction of staff, reduction of staff in a particular class or the employer ceasing or planning to cease trading. In most cases, individuals being retrenched also do not hold more than 5% of the shares or members' interest in the employer company. We thus agree with the submission that a voluntary severance package usually meets all the requirements for a "severance benefit" in terms of the Income Tax Act 58 of 1962 (the Act) and should accordingly be granted the same tax treatment as involuntary severance packages.

We agree with the proposal that the Sars Completion Guide be updated to remove the distinction between "voluntary" and "involuntary" retrenchments as this distinction does not exist in the definition of "severance benefit" in the Act.

As a result of the submission, Sars has accepted that voluntary severance packages on retrenchments should in the interim be disclosed under the "severance benefits - involuntary retrenchment" option in the IRP3(a) form in order for the "severance benefit" table to apply to such lump sums. This is the position while the Sars Completion Guide and forms are updated to reflect the change in Sars practice and policy.

In terms of current tax tables, the first R500,000 of a severance benefit (excluding leave and notice payments) received in the lifetime of the individual is exempt from normal tax, with the remainder taxed at increasing marginal rates with 36% being the maximum rate. The clarification that voluntary severance packages qualify as severance benefits is to be welcomed as it has significant financial implications to employees who are retrenched.

As employers could be, amongst others, personally liable for shortfalls of PAYE withheld, we recommend that legal and tax advice be obtained as early as possible in any proposed business restructuring or retrenchment.

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