

Voluntary retrenchment may no longer be an easy sell

By [Stephan Spamer](#), [Lauren Salt](#), and [Ryan McKerrow](#)

9 Mar 2018

The current South African Revenue Service (Sars) IRP3(a) Completion Guide, which aids employers in completing tax directive applications for their employees, appears to introduce a distinction between voluntary and involuntary severance benefits. This apparent distinction has the potential to be interpreted as a differential tax treatment of the two benefits.



© rawpixel – [123RF.com](#)

As a result of this, the South African Institute of Tax Professionals (SAIT) submitted representations to Sars on the issue - claiming that there should be no distinction between the two as they both fall within the definition of a "severance benefit".

By way of a background, the definition of "severance benefit" contained in section 1(1) of the Income Tax Act (ITA) does not differentiate between severance benefits paid in the context of voluntary or involuntary retrenchments. As a result, where employers applied for a tax directive from Sars in the context of severance benefits paid in either scenario, their employees received a tax-break on the first R500,000. This is a once-off benefit, but can be used over multiple retrenchments. Put differently, if the entire benefit is not used in one retrenchment, the remainder of the benefit (up to R500,000) can be used in a further retrenchment(s).

In their submission to Sars, entitled "Tax Treatment of Severance Benefit Received in Consequence of Voluntary Retrenchment", the SAIT noted that, in the new Sars IRP3(a) Completion Guide, "there is an implicit interpretation that 'voluntary retrenchment' does not qualify for the normal tax treatment of severance benefits" and that this could have a negative impact on taxpayers.

In terms of South African employment law, voluntary retrenchment is a commonly used alternative to dismissal, or forced retrenchment. With voluntary retrenchment the employee is generally required to sign a waiver of all claims against the employer and would be precluded from referring a claim of unfair dismissal as the termination would be an agreed termination, as opposed to a dismissal. Some of the selling points of voluntary severance are that (i) the amount offered is usually more than the statutory minimum which would be payable in the forced termination context, and (ii) the amount would be tax-free up to the value of R500,000 (assuming that the employee has not previously used up their benefit).

A consequence of a potential differential tax treatment would be that employees may not be better off by taking up a voluntary severance package if the severance benefit is subject to tax (in all circumstances). The more appealing option may be to be retrenched (forcibly), receive the tax-break on the severance benefit payable and still retain the right to refer an unfair dismissal claim.

Coding and capturing

According to the Sars IRP3(a) Completion Guide, the distinction between the two categories is as follows: "The reason 'Severance Benefit – Involuntary Retrenched' must only be used where the employer is planning to stop trading or due to a general reduction of staff. This reason cannot be used for dismissals or restructuring... The reason 'Severance Benefit – Voluntary Retrenched' must only be used where a lump sum is paid as a result of restructuring or other termination of employment; and this tax directive reason can be used if a retrenchment lump sum is payable but not in terms of the requirements of section 1(1) 'severance benefit' paragraph (c) of the Act."

The SAIT explained that this classification creates the problem that "a voluntary severance package, which in law meets all the requirements for the 'severance benefit' tax treatment, will have to be coded as 'involuntary' to qualify for the correct tax treatment".

Sars has subsequently released a communication stating that, when completing tax directives, employers should note that, for now, voluntary severance benefits should be captured under the involuntary category.

Employers should therefore ensure that, until Sars has formally dealt with the discrepancy, they should apply for tax directives for voluntary severance benefits by capturing the benefit under the "involuntary retrenchment" classification, so that their employees receive the severance tax benefit.

ABOUT THE AUTHOR

Stephan Sparrer, Head of Tax, Lauren Salt, Senior Associate, Employment & Compensation, and Ryan McKerrow, Candidate Attorney, Baker McKenzie Johannesburg.

For more, visit: <https://www.bizcommunity.com>