

Clarity regarding tax treatment of retrenchment benefits

Beneficial tax treatment is available in respect of payments made to individuals, which fall within the definition of 'severance benefit', in terms of section 1 of the Income Tax Act, 1962 (the Act).

Severance benefits include an amount paid to:

- a person on the termination or loss of employment as a result of that person's employer having ceased to carry on, or intending to cease carrying on, the trade in respect of which the person was employed or appointed; or
- a person having become redundant in consequence of a general reduction in personnel or a reduction in personnel of a particular class by the person's employer,

unless, where that person's employer is a company, the person at any time held more than five per cent of the issued shares or members' interest in the company. This benefit therefore relates to what is generally referred to as a retrenchment benefit.

If the above-mentioned requirements are met, the severance or retrenchment benefit is to be taxed in terms of the Retirement & Death Benefits or Severance Benefits tax table, which means that on the first severance benefit received, the taxpayer will enjoy an exemption from income tax of the first R500 000 of that benefit, with tax payable only on the balance in terms of the table.

For the first time last year, SARS drew a distinction between 'voluntary' and 'involuntary' retrenchments with reference to this type of severance benefits. This distinction was made in SARS' **Completion Guide for IRP3(a) and IRP3(s) Forms (the Guide)**. In terms of the Guide, the SARS view was that voluntary retrenchment is that which is as a result of restructuring or other termination of employment. This is presumably where an employee was dismissed, given the specific reference to dismissal, when dealing with 'involuntary' retrenchment.

The Guide referred to 'involuntary' retrenchment as being applicable only where the employer stops trading or due to a general staff reduction. It specifically stated that 'involuntary' retrenchment is not the same as restructuring or dismissal. Two different fields were provided in the IRP3(a) for disclosure of 'voluntary' versus 'involuntary' retrenchment payments thereby leading to 'voluntary' retrenchment payments not being allowed the same tax benefits as 'involuntary' retrenchment payments.

In our view, this distinction drawn by SARS is incorrect and not in terms of the legislation, which provides specific requirements for amounts to be considered severance benefits. To the extent that the legislative requirements are met, regardless of whether or not the retrenchment was considered 'voluntary' as opposed to 'involuntary', the tax treatment should be the same.

SARS has been engaged on this matter and they have noted that they have been reconsidering their position and they seem to agree that regardless whether the severance



benefit is 'voluntary' or 'involuntary', the same tax benefits would be available. Given that it will take time for the Guide and forms to be updated accordingly, SARS have advised that 'voluntary' retrenchment severance benefits should in the meantime be disclosed as 'involuntary' retrenchment severance benefits to ensure the beneficial tax treatment is applied.