

29 January 2018

The South African Revenue Service
Lehae La SARS, 299 Bronkhorst Street
PRETORIA
0181

Attention: Gary Edwards

Per email: [REDACTED]

TAX TREATMENT OF SEVERANCE BENEFIT RECEIVED IN CONSEQUENCE OF VOLUNTARY RETRENCHMENT

We appreciate the opportunity to raise this matter with you.

1. PROBLEM

- 1.1 SARS recently issued a *Completion Guide for IRP3(a) and IRP3(s) Forms*, in terms of which there is an implicit interpretation that “voluntary retrenchment” does not qualify for the normal tax treatment of severance benefits. This implicit interpretation could create a negative impact on taxpayers.

2. SO-CALLED “VOLUNTARY RETRENCHMENT” IN EMPLOYMENT LAW

- 2.1 The concept of a “voluntary retrenchment” (as opposed to a “forced retrenchment”) exists in employment law and our courts have held that voluntary retrenchment agreements are valid and enforceable contracts. In terms of such agreements, it is common practice in South Africa for an employer to offer employees, subject to the employer’s operational requirements and skills retention needs, an opportunity to accept voluntary retrenchment on the basis of an enhanced severance package payment.

- 2.2 The employer is free to determine the amount of the enhanced voluntary severance package that it will offer to its employees. For example, an employer may increase the minimum amount of severance pay from 1 week's remuneration for every completed year of service to between two to three weeks' remuneration (or salary) for every completed year of service. Alternatively, the employer may offer the employee another once-off payment.
- 2.3 Where an employer has offered an employee a voluntary severance package, it is also customary to enter into an agreement with the employee who opts for voluntary retrenchment, in full and final settlement of all claims that the employee may have against the employer arising out of the termination of the employment relationship. In other words, such an agreement precludes the employee from suing the employer in respect of the termination of his/her employment, which ensures finality and avoids litigation.
- 2.4 However, in order for such a waiver to be enforceable, the employee must be paid something more than what s/he would be legally entitled to – in our law, a waiver in consideration for what an employee is legally owed is not enforceable. Accordingly, in addition to the payment of accrued annual leave pay, notice pay, severance pay and any other contractually guaranteed amounts, the employee should be paid enhanced severance pay.

3. SARS' IMPLICIT VIEW ON THE DISTINCTION BETWEEN VOLUNTARY AND INVOLUNTARY RETRENCHMENT

- 3.1 SARS recently issued a *Completion Guide for IRP3(a) and IRP3(s) Forms* in terms of which it introduces a new classification between a "Severance benefit – Voluntary retrenchment" and a "Severance benefit – Involuntary retrenchment" which must be used by an employer when indicating the reason(s) for submitting a Tax Directive Application.
- 3.2 According to the SARS 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 application must be in terms of section 1(1) “severance benefit” paragraph (c) on the Act.”¹

“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.”²

- 3.3 This new classification appears to reflect an interpretation that in the case of a voluntary severance package, the employee does not qualify for the more favourable tax treatment applicable to a “severance benefit”.
- 3.4 This also creates the practical anomaly/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.

4. OUR VIEWS ON THE NEW DISTINCTION

- 4.1 We do not agree that a voluntary retrenchment package is not a “severance benefit” as is implied in the SARS Guide.
- 4.2 From a tax perspective, it must be noted that the Income Tax Act itself does not differentiate between voluntary and forced retrenchment packages. In this respect, paragraph (c) of the definition of a “severance benefit” deals with amounts paid on retrenchment of an employee, and does not refer to the terms “voluntary” or “involuntary”. If the amount to be paid in terms of the voluntary retrenchment agreement is covered in terms of paragraph (c), it should constitute a severance benefit, irrespective of whether it is regarded as “forced” or “voluntary” from an employment law perspective.
- 4.3 It is important to note that in both voluntary and involuntary retrenchments, the employee is being retrenched because of a general reduction in personnel or a reduction in personnel of a particular

¹ At page 10

² At page 11

class. It is accordingly submitted that the relevant termination of office falls within paragraph (c)(ii) of the definition of a severance benefit. The lump sum payable on termination in respect of a voluntary retrenchment should thus constitute a severance benefit for tax purposes.

5. PROPOSED SOLUTION

- 5.1 We believe that the SARS *Completion Guide for IRP3(a) and IRP3(s) Forms* should be updated, to not differentiate between “voluntary” and “involuntary” retrenchment (which is not a differentiation that is made in the actual definition of “severance benefit”).
- 5.2 Rather, the guide should refer to termination or loss of employment as a result of a general reduction in personnel or a reduction in personnel of a particular class, or the employer ceasing to carry on trade in respect of the employment; persons of the age of 55 years or older; and termination of employment because of being permanently incapable of employment due to sickness, accident, injury or incapacity through infirmity of mind or body. All of these situations fall within the definition of “severance benefit”. In contrast, other termination of employment, such as mutual separation in other circumstances, do not fall within the definition of “severance benefit”.

6. CONCLUSION

We would appreciate the opportunity for further engagement on this matter.

Yours sincerely

Erika de Villiers

Head of Tax Policy