TAX

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THE TAX FREE NATURE OF A VOLUNTARY SEVERANCE PACKAGE

Loss of employment through retrenchment (forced or voluntary) is a reality many employees face in the current economic climate. Over the last number of years, various tax concessions have been made to ease the financial burden on employees facing retrenchment, mainly in the form of tax free thresholds which apply to certain lump sum employer payments.

Navigating the tax pitfalls of retrenchment is important, as it is not necessarily guaranteed that all forms of payment upon retrenchment will qualify for preferential tax treatment.

Currently, the Income Tax Act, No 58 of 1962 (Act) provides for a R 500,000 lifetime exemption (effective 1 March 2014) in respect of a "severance benefit". A "severance benefit" for the purposes of the Act is, essentially, any employer paid amount (excluding retirement fund lump sums) received by or accrued to a person by way of a lump sum in respect of the relinquishment, termination, loss, repudiation, cancellation, or variation of office or employment, provided at least one of the following requirements is satisfied:

- the person has attained the age of 55;
- the termination or relinquishment of office is due to sickness, accident, injury, or incapacity through infirmity of mind or body;
- the termination or loss is due to the employer having ceased, or intending to cease, carrying on the trade in respect of which the person was employer; or
- the termination or loss is due to the person having become redundant in consequence of a general reduction in personnel or a reduction in personnel of a particular class.

Qualification of an amount as a "severance benefit" needs to be carefully considered where the termination or loss is due to the person having become "redundant" in consequence of a general reduction in personnel or a reduction in personnel of a particular class. In certain cases, the affected employees are offered a Voluntary Separation Package (VSP) and the following question arises: Does a payment in the form of a VSP pursuant to redundancy, qualify for tax preferential treatment?

There is no definition of "redundant" in the Act and as such, it should take on its ordinary meaning for tax purposes, bearing in mind that the concept of redundancy bears its own meaning for labour law purposes.

Based on the fact that a VSP process is essentially a bilateral negotiation between the employer and the employee, there is a school of thought that any payment resulting from the voluntary termination process does not fall within the definition of "severance benefit". The reason being that the payment was not as a result of the employee's position becoming "redundant". In other words, in order for an amount to (seemingly) qualify as a "severance benefit" (incorrectly in our view), it needs to be paid as a result of an employer's unilateral decision or, stated differently, a forced retrenchment.

It is arguable that, but for the general reduction of personnel by the employer, there would have been no payment and that the structure of the "severance benefit" definition is such that it contemplates a process (ie a legislated labour law process), which ultimately culminates in a particular employee being regarded as "redundant", which then results in the payment of an amount taking the form of, among other possibilities, a VSP.

When an employer embarks on a VSP process, the employer has already made a decision to effect a general reduction in employees. It follows that, once an employee elects to receive a VSP, the employee accepts that he or she is "redundant" and the payment made by the employer, as a consequence of the VSP, is a payment that the employee would not have received, had he or she not been affected by the proposed redundancy. The interpretation that being "redundant" only contemplates the result of a forced retrenchment is, in our view, too narrow, as the decision to make a "general reduction" in personnel is part of a wider

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process that, by implication, includes a voluntary element. It may, however, be required by the particular employer to completely remove the affected position function from its organisational structure, despite the process being inherently voluntary.

Employers, therefore, need to tread carefully and plan accordingly where a retrenchment process is contemplated, so as to ensure that a VSP results in the most tax effective outcome for affected employees. Employers should also be careful not to oversell a VSP where the VSP arguably does not fall within the requirements of a tax-free "severance benefit".

Ruaan Van Eeden

ZERO RATING – GOODS DELIVERED BY A CARTAGE CONTRACTOR

In order to provide the necessary legislative amendments required to implement the tax proposals that were announced in the 2015 National Budget on 25 February 2015, the National Treasury published the Draft Taxation Laws Amendment Bill (TLAB), 2015, on 22 July 2015 for public comment.

One of the proposed amendments relates to the zero rating of movable goods physically delivered by a cartage contractor, in terms of a sale or instalment credit agreement, to a customs controlled area enterprise or an Industrial Development Zone (IDZ) operator in a customs controlled area.

By way of background, the South African value-added tax (VAT) system is destination based which means that only the consumption of goods and services in South Africa is taxed. VAT is therefore levied at the standard rate of 14%, on the supply of goods and services in South Africa as well as on the importation of goods into South Africa unless an exemption or exception applies.

The primary mechanism to ensure that only local consumption is taxed in South Africa is through the zero rating (0%) of certain exported goods and services. In other words, where goods or services are exported from South Africa, the goods will be consumed outside of South Africa and accordingly, the supply of such goods or services should not attract VAT in South Africa.

The main consideration in respect of zero rating under South African VAT law is the application of s11(1)(a) of the Value-Added Tax Act, No 89 of 1991 (VAT Act). In essence, s11(1)(a) of the VAT Act provides for the zero rating of the supply of goods, where the goods are exported from a place in South Africa to a place in an export country.

The term "exported" is defined in s1 of the VAT Act and includes, among others:

- goods consigned or delivered by the vendor to the recipient at an address in an export country as evidenced by documentary proof acceptable to the Commissioner for the South African Revenue Service (direct export); or
- goods removed from South Africa by the recipient or the recipient's agent for conveyance to an export country in accordance with any regulation made by the Minister of Finance (indirect export).

Section 11(1)(m) of the VAT Act deals with the zero rating of the supply of movable goods, in terms of a sale or instalment credit agreement, to a customs controlled area enterprise or an IDZ operator in a customs controlled area being delivered by a registered cartage contractor. Currently s11(1)(m)(ii) provides that the movable goods must be delivered by a registered cartage contractor, whose "main activity" is transporting goods and who is engaged by the supplier to deliver the goods and that supplier is liable for the full cost relating to that delivery. The South African Revenue Service (SARS) defines a cartage contractor in Interpretation Note 30 (Issue 3) of 5 May 2014 (IN 30) as "a person whose 'activities include' the transportation of goods, and includes couriers and freight forwarders".

Having regard to the above, the term "cartage contractor", as defined in IN 30, has a wider application than the VAT Act's current requirement pertaining to zero rating. IN 30 requires that in order for the transaction to be zero rated, the cartage contractor's "activities must include" the transportation of goods, whereas the VAT Act requires that the transaction will only be zero rated if the "main activity" of the cartage contractor is the transportation of movable goods.

In order to align the VAT Act with IN 30, the TLAB proposes that the words "main activity" in s11(1)(m)(ii) of the VAT Act be replaced with "activities include" (as defined in IN 30) to allow for the zero rating of goods physically delivered by a registered cartage contractor whose activities include that of transporting of goods.

The proposed amendment will seemingly relax the adherence to the strict requirements imposed by the VAT Act pertaining to the zero rating of the supply of movable goods where such goods are physically delivered by a cartage contractor to an offshore entity in a customs controlled area. This, in turn, will assist vendors in avoiding the pitfalls associated with the aforementioned transactions.

The proposed amendments will come into operation on 1 April 2016. Public comments on the proposed amendments are due by close of business on 24 August 2015.

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