

# EMPLOYMENT

## 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.

*continued*



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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 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*

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