

# ASAP

## Legal and Technical Update

### Severance Benefits

A severance benefit is defined by the Income Tax Act. It is as follows:

- it is any amount received by or accrued to a person,
- by way of a lump sum from the person's employer,
- excluding lump sums as contemplated in paragraph (d) of the gross income definition, (which includes unapproved group life cover and deferred compensation benefits),
- in respect of the relinquishment, termination, loss, repudiation, cancellation or variation of a person's employment, if:
  - o such a person is 55 years old, or
  - o such relinquishment, termination, loss, repudiation, cancellation or variation is due to the person becoming permanently incapable of holding the person's office or employment due to sickness, accident, injury or incapacity through infirmity of mind or body, or
  - o such termination or loss is due to:
    - the 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
    - the 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,
    - EXCEPT where the person's employer is a company or close corporation and the employee/person at any time held more than five percent of the issued share capital or members' interest in that entity.

Where the amount becomes payable upon the death of a person, it shall be deemed to have been paid the day immediately prior to death. Therefore the deceased will be taxed on the lump sum received.

#### **Important note:**

Based on the interpretation of the definition, not all severance benefits are necessarily retrenchment benefits (i.e. the lump sums covered in the definition is not always paid out due to redundancy/retrenchment).

On the other hand, all retrenchment packages paid due to redundancy will fall within the definition of a severance benefit and will therefore enjoy the tax treatment (unless the employee held more than 5% of the shares/interest in the employer-company or CC at any time).

## Retirement fund withdrawal made due to the loss of employment as a result of retrenchment

Paragraph 2(1)(a)(ii) of the Second Schedule to the Income Tax Act determines the following:

Any lump sum withdrawal made from an employer retirement fund (pension or provident fund – does not include corporate retirement annuities),

- as a result of the termination of employment due to the employer ceasing to carry on the business, or
- due to the employee becoming redundant due to a general reduction in personnel,

will be taxed in terms of the retirement fund tax table applicable on death or retirement, UNLESS, the taxpayer held more than 5% of the issued share capital or members' interest in the employer-company or CC at any time, in which case it will be treated as a normal retirement fund withdrawal and taxed according to the withdrawal tax table.

This withdrawal has to be made when leaving the employer retirement fund due to retrenchment and cannot be delayed until a later stage or taken from a preservation fund. In that case the withdrawal will be taxed according to the withdrawal tax table.

### How is this amount taxed?

If an amount qualifies as a severance benefit or if the provisions of paragraph 2(1)(a)(ii) as discussed above applies, the lump sum will be taxed according to the tax table applicable to retirement fund lump sums payable upon retirement or death. It is as follows:

Taxable Income (R)	Rate of Tax (R)
0 – 500 000	0% of taxable income
500 001 - 700 000	18% of taxable income above 500 000
700 001 -1 050 000	36 000 + 27% of taxable income above 700 000
1 050 000 +	130 500 + 36% of taxable income above 1 050 000

All lump sums received by a taxpayer from retirement funds are aggregated when applying the tax tables and the severance benefit will also be added to the aggregated amount.

Aggregation applies in respect of the following lump sums received:

- retirement fund lump sums received after 1 October 2007,
- withdrawal lump sums received after 1 March 2009,
- severance benefit lump sums received after 1 March 2011.

### Practical note:

In practice, where the severance benefit is received and a lump sum amount is withdrawn from the employer retirement fund due to retrenchment, the sequence in which the directives are applied for will influence the aggregation of the two amounts when determining the tax payable.

**Important note:**

A severance benefit cannot be transferred to a retirement fund as it does not originate from a retirement fund. Therefore it will always impact the tax free portion available at retirement due to aggregation.

**Practicalities**

Where an employee receives a lump sum from their employer due to the termination of employment, **that lump sum WILL BE treated as a severance benefit and taxed in terms of the retirement fund RETIREMENT/DEATH tax table, IF:**

- ✓ The employee is over the age of 55 years, irrespective of the reason for the termination of employment;
- ✓ If the employee’s employment is terminated due to ill health or permanent disability, irrespective of the person’s age;
- ✓ If the employment is terminated due to retrenchment, irrespective of the age of the person and the employee **DOES NOT OR HAS NEVER** held more than 5% of the shares/interest of the employer-company or CC. (This includes voluntary and involuntary retrenchment).
- ✓ If the employee makes a withdrawal from the employer pension or provident fund (even if the employee is not eligible for retirement or early retirement) at the time of being retrenched.

Where an employee receives a lump sum from their employer due to the termination of employment, **that lump sum WILL NOT BE treated as a severance benefit and it will be taxed in terms of the retirement fund WITHDRAWAL tax table, IF:**

- x The employee is younger than 55 and the employment is terminated for any reason other than ill health, disability, or retrenchment;
- x The employee is retrenched and **HOLDS MORE OR DID HOLD MORE** than 5% of the shares or interest in the employer-company or CC;
- x The employee transfers the employer-retirement fund benefit to a preservation fund upon retrenchment and then makes a subsequent withdrawal from the preservation fund at a later stage.

The withdrawal tax table is as follows:

Taxable Income (R)	Rate of Tax (R)
0 – 25 000	0% of taxable income
25 001 - 660 000	18% of taxable income above 25 000
660 001 - 990 000	114 300 + 27% of taxable income above 660 000
990 001 and above	203 400 + 36% of taxable income above 990 000

**Important note:**

Disallowed contributions can only be offset against the lump sum withdrawal made from the retirement fund and cannot be applied against a severance benefit to reduce the taxable lump sum. Tax tables can change and should be confirmed before giving advice to clients.

### **Lave pay and other similar amounts**

When an employee's services are terminated, the employee may be entitled to:

- leave pay, in lieu of leave not taken,
- notice pay, in lieu of the contractual notice period that they are not required to work,
- pro-rata bonuses in terms of their employment contract.

These amounts do not qualify as severance benefits, and will be fully taxable at the employee's marginal tax rate, as part of gross income.

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