

Qualifying retrenchments

Practice Note 11 version 2 July 2019

Tax payable in terms of the current
Income Tax Act



Introduction

The Operations & Administration division (O&A) issue practice notes to:

- Increase awareness and provide insight into the best practices and procedures adopted by AlexForbes for the effective administration of your fund
- Clarify our administration role
- Align expectation between AlexForbes, trustees, employers and members of the retirement funds.

Please note that in an event of a conflict, the fund's rules, applicable legislation or the signed service level agreement will take precedence over the processes set out in this practice note.

In this issue, we highlight the effect of the Taxation Laws Amendments Act 2009 (Act 17 of 2009) and the Taxation Amendment Act (Act 7 of 2010) and the effect this has on retrenchment benefits that qualify in terms of the Income Tax Act, where the lump sum benefit will be taxed as a retirement benefit.

Background

The Taxation Laws Amendment Act 2009 (Act 17 of 2009) that was promulgated on 30 September 2009 introduced some tax relief for lump sum benefits payable by retirement funds in certain instances of termination of employment. Where the lump sum benefit is in respect of a qualifying retrenchment, the lump sum benefit will be taxed as a "retirement benefit" i.e. currently the first R500 000.00 is taxed at 0%. The benefit will still form part of the aggregation of all lump sum benefits received from retirement funds, i.e. reduce the amount available as a tax free benefit upon retirement from the fund.

In terms of paragraph 2(1)(a)(ii) of the Second Schedule of the Income Tax Act, the criteria which should be considered for a qualifying retrenchment is summarised as follows:

That the member's termination or loss of employment is due to:

- his or her employer having ceased to carry on or intending to cease to carry on the trade in respect of which the member was employed; or
- that member having become redundant in consequence of his or her employer having effected a general reduction in personnel or in a particular class of personnel.



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- Provided that this sub item does not apply to any amount received by or accrued to a person by way of a lump sum benefit where the person's employer is a company and that person at any time held more than five percent of the issued share capital or member's interest in that company."



All taxpayers are only entitled to the tax free concession (currently R500 000.00) once over the member's lifetime. The tax free concession is subject to change by the Minister from time to time.

In February 2010, a letter was sent out by AlexForbes to all employers/paypoints explaining the impact that the Taxation Laws Amendment Act 2009 would have on taxing retrenchment benefits and the amended claim form that needed to be used for all future claims.

In terms of the Income Tax Act, only those persons who meet the requirements of "Qualifying Retrenchments" (defined below) are entitled to the favourable tax exemption (currently R500 000.00 at 0%) and in the SARS tax application form, this is referred to as "Involuntary Termination of Employment".

"Qualifying Retrenchment" means retrenchment from employment which is in line with the provisions set out in paragraph 2(1)(a)(ii) of the Second Schedule of the Income Tax Act, as set out above. With effect from 1 March 2011, the criteria regarding whether a member was a director of a company was removed. Upon retrenchment of an employee where an employer has applied for tax clearance on the severance benefit paid to the retrenched employee and the tax payer has received the tax free concession (currently R500 000.00) on the severance benefit paid, the taxpayer will not be allowed a further concession, as a member of the fund.

Whether a member was voluntarily or involuntarily retrenched, the Employer would have followed the process as prescribed in the Labour Relations Act, in order to enforce the retrenchment. In this regard, there

is no distinction between voluntary and involuntary retrenchments.

Which documents must the employer forward to the fund for a "Qualifying Retrenchment"?

Only the fully completed withdrawal claim form is required. By the employer completing, signing and stamping the claim form with the company stamp, it confirms that the employer has considered the applicable legislation in the Income Tax Act.

Is there a difference between voluntary and involuntary retrenchments?

There is currently no difference between voluntary and involuntary retrenchments and all benefits are calculated in terms of the rules of the fund i.e. retrenchment benefits. For taxable purposes, where the retrenchment meets the criteria of "Qualifying Retrenchment" in terms of the Income Tax Act, the South African Revenue Services (SARS) will tax the lump sum benefit as a "retirement benefit" i.e. currently the first R500 000.00 is taxed at 0%.

Does AlexForbes make the choice of which benefits should be taxed as a "Qualifying Retrenchment"?

No - AlexForbes does not make this choice. AlexForbes will apply for a tax directive to SARS in terms of the information that is provided on the claim form and SARS will tax the benefit accordingly.

When should the box reason for withdrawal on the claim notification form - "Non-Qualifying Retrenchment" be used/ticked?

This should only be used where the member that has been retrenched, has more than 5 % of the issued share capital or member's interest in that company.



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