

## **TAX ON MONTHLY GRATUITY & GRATUITY ADVANCES : By Jonathan Hore**

Welcome folks to today's instalment of my weekly tax articles. I want to talk about the payment of gratuities on a monthly basis as well as advances against gratuities and the tax treatment thereof. A gratuity is a terminal payment which is usually paid in pursuance of the terms of a contract of employment. The arrangement for gratuities is such that they are payable at the end of an employment contract. If an employee is on a 5 year contract, the gratuity is usually paid at the end of that 5 year period. Likewise, if an employee is on a 2 year contract, their gratuity is paid at the end of that 2 year contract. Before I get to the hot issues of monthly gratuity payments and advances against gratuities, I will first lay the background to tax on gratuities. Throughout this article, words importing the masculine shall be deemed to include the feminine.

### **GENERAL TAX TREATMENT OF GRATUITY**

Well, most of you may know that a gratuity is taxed to the extent of two thirds whilst one third is exempt. In other words, if one gets a gratuity of P 120 000, P 40 000 will be exempt, being one third whilst P 80 000 remains taxable. Human resources experts however advise us that the gratuity accrues every month, i.e. the employer should determine and accrue for the gratuity on a monthly basis. The taxable amount triggers tax in the month in which the payment is actually made to the employee. This is similar to the way we treat leave days, i.e. they accrue every month but only get taxed when they are paid to an employee. By way of emphasis, gratuities are eligible for the one third if they are paid at the end of or on renewal of a contract.

### **GRATUITY PAYMENTS TO NON-CITIZENS**

The Income Tax Act prescribes that, *'where a non-citizen employee is entitled to a bonus or gratuity under a contract of employment, one third of such bonus or gratuity shall be excluded from his gross income, and the remaining two thirds thereof shall be deemed to have accrued evenly over the duration of the contract or over the last three years thereof, whichever is the lesser... provided further that one third of the bonus or gratuity mentioned herein shall only be excluded from the gross income of a non-citizen employee if in the opinion of the Commissioner the payment is reasonable in the circumstances having regard to — (a) the period of the employment..'*

Again, a gratuity payable to a non-citizen is subject to one third exemption but BURS is required to make a pronouncement of *'the period of the employment..'* under which the exemption will apply. Well, BURS has already made it categorically clear that non-citizens can only enjoy the one third exemption if they have served at least 2 years of a contract of employment. Technically, a gratuity payment made to a non-citizen before the expiration of 2 years will not be subject to the one third exemption. However, the 2 years is assuming that the employee's contract of employment is not, for some reason, terminated. The big question that arises is whether the one third exemption will still apply even when the non-citizen is paid the gratuity before 2 years due to the termination of the employment contract. It appears that BURS will only regard the one third exemption under minimum periods of service of 2 years. For citizens, the one third exemption should apply at any time that the contract is terminated or renewed.

### **THE HOT ISSUE: MONTHLY PAYMENTS**

It often happens that some employers pay gratuities on a monthly basis, to both citizens and non-citizens and still apply the one third exemption. Technically, making monthly gratuity payments causes the gratuity to change its nature to some form of an allowance

and the 'terminal payment' characteristic fades away. Once we agree that the gratuity loses its terminal payment nature, then monthly gratuity payments should not be eligible to the one third exemption. In other words, I am of the unwavering view that monthly gratuity payments should be taxed without the one third exemption. This is a common mistake that is done by most employers and it exposes them to massive tax penalties in case they are audited by BURS.

### **ANOTHER HOT ISSUE: GRATUITY ADVANCES**

A number of employers also allow their employees to access advances of their gratuities before the end of their employment contracts. At the end of the employment contract, they then subject the total amount of the gratuity to the one third exemption, deduct the amount advanced and pay the balance to the employee. Again, that tampers with the gratuity principle, being that it is a terminal payment which should only be paid at the end of or on renewal of a contract. Technically, the one third exemption should be lost once an employee accesses these gratuity advances as the exemption is meant to be granted at the expiration of an employment contract or at the end of a 2 years of service for non-citizens. Paying gratuity advances is highly likely to cause any knowledgeable person to frown at that arrangement as the 'terminal nature' of the gratuity is compromised.

Well folks, I hope that was insightful. As Yours Truly says goodbye, remember to pay to Caesar what belongs to him.