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EARLY ACCESS TO GRATUITY MAY TRIGGER TAX: By Jonathan Hore

It is general practice that gratuities are accessed at the end of an employment contract and by nature, they are terminal payments. However, it often happens that some employees access the gratuities through various forms, including getting advances against their gratuity and receiving monthly gratuity payments. These arrangements are put in place by employers but they have possible tax implications, which need to be considered. I dedicate this article to analysing the possible tax implications that may arise when gratuities are accessed earlier than their due dates. In this article, words importing the masculine shall be deemed to include the feminine.

TAX TREATMENT

A gratuity that is payable at the end of a contract is only taxed to the extent of 66.67% as the first 33.33% is exempt from tax. This makes gratuity payments attractive to employees due to the tax exemption. Gratuities are usually offered to employees who are on fixed term employment contracts. The length of the contracts may vary from employer to employer and such validity of the contract does not usually affect the tax treatment of the gratuity. Some of the contracts may be renewable after 2 or 5 years and the tax treatment remains the same, i.e. the first 33.33% is exempt from tax. For non-citizens, the contract should be a minimum of 2 years in order for the exemption to apply. The 2-year limit was set by BURS pursuant to the stipulations of the Income Tax Act. I have never seen any limit to the time that the employment contracts should be for citizen employees.

MONTHLY GRATUITIES

It often happens that some employers choose to pay the gratuities to employees on a monthly basis and still apply the 33.33% exemption. Whilst that appears to be an innocent arrangement, it has the effect of distorting the whole gratuity concept. Put simply, a gratuity is paid whenever a contract is terminated or when it is terminated and then renewed. Paying the gratuity on a monthly basis gives the impression that the employer terminates and renews the employees' contract on a monthly basis, which is rather unusual. Due to that treatment, the gratuity ceases to become a terminal payment as no employee is terminated and re-engaged on a monthly basis. The effect is that the gratuity loses its nature and therefore becomes taxable in full. The employee also loses on the tax exemption whilst the employer may be exposed to taxes as the 33.33% exemption falls off.

ADVANCES AGAINST GRATUITY

Some employers have arrangements where employees access their gratuities in the form of advances. Technically, such arrangements are referred to advances secured by gratuities. What this means is that if an employee accrues P300 000 in gratuities, they are allowed to access the gratuity in the form of an advance secured against the P300 000. As an example, the employee may get an advance of P 200 000 during the contract period and they then get the balance of P 100 000 at the end of the contract. If that happens, then the P200 000 that is accessed early ceases to strictly be a gratuity as it would have been accessed before the end of the contract. This then casts doubt on the tax treatment of such gratuity as it is solely supposed to be accessed at the end of the contract. Whilst there is nothing in black and white from BURS on this matter, my view is that any gratuity that is accessed before the contract ends is not eligible for the 33.33% tax exemption as its nature is distorted. This could also be an issue of contention in case of a tax audit by the taxman.

CONCLUSION
It can be seen from the analogy above that gratuities are ideally supposed to be paid when contracts expire. As such, before employers temper with gratuities, it is advisable that they seek the tax advice on such arrangements in order to minimise tax exposures.

Well folks, I hope that was insightful. As Yours Truly says goodbye, remember to pay to Caesar what belongs to him. If you want to join our Tax Whatsapp group, send me a text on the cell number below.

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