



SOUTH AFRICAN REVENUE SERVICE

INTERPRETATION NOTE NO. 26

DATE: 30 March 2004

ACT : INCOME TAX ACT, NO 58 OF 1962 (the Income Tax Act)
SECTION : Section 1 definition of “gross income”, paragraph(c), paragraph(d) and paragraph(f): Section 10(1)(x): Section 7A(4A)
SUBJECT : The Taxation of CCMA and Labour Court Awards to Employees and Former Employees

1. Purpose

The purpose of this interpretation note is to provide guidelines on the taxability of CCMA and Labour Court awards to employees and former employees, arising from the application of labour law. Labour law may be described as the regulation of the rendering of services by means of common law, statutory measures, as well as case law.

2. Background

Various Dispute Resolution Mechanisms:

2.1 The Commission for Conciliation, Mediation and Arbitration

The main function of the Commission for Conciliation, Mediation and Arbitration (CCMA) is to attempt to conciliate and, if conciliation fails, to take steps to arbitrate such disputes. The CCMA will only have jurisdiction to arbitrate a dispute if a matter is referred to it by a party to a dispute and if the Labour Relations Act, 1995 allows for the arbitration. Even where the Labour Relations Act, 1995 provides for the Labour Court to

arbitrate, the CCMA is obliged to arbitrate the matter if all the parties to a dispute request the CCMA to arbitrate. Some examples of the matters that may be arbitrated by the CCMA in accordance with the Labour Relations Act, 1995 are:

- Disputes about certain unfair dismissals.
- Certain residual unfair labour practices.
- Application for the removal of a member of a workplace from office.
- Disputes concerning the interpretation and application of the Labour Relations Act, 1995 concerning workplace forums.
- Disputes of mutual interest.
- Disputes concerning disclosure of information.
- Disputes concerning organisational rights.
- Disputes in essential services when parties are not allowed to strike, or lock out.
- Where parties fail to agree on matters of joint decision-making at work-place forums.

2.2 The Labour Court

The Labour Court of South Africa has similar authority and powers to those of a high court in relation to matters that fall under its jurisdiction. It has exclusive jurisdiction in respect of all matters provided for in the Labour Relations Act, 1995, or where any other Act of parliament gives it jurisdiction. Examples of matters in which the Labour Court has exclusive jurisdiction are:

- The review of arbitration awards of the CCMA.
- Automatically unfair dismissals.
- Dismissals for operational reasons.
- Dismissals flowing from strikes or closed shop agreements.
- Unfair labour practice disputes concerning discrimination.

2.3 The Labour Appeal Court

The Labour Appeal Court is the final court of appeal in respect of all judgments and orders made by the Labour Court, provided that the matter falls within its exclusive jurisdiction. It is a superior court and has similar authority and powers to those of the supreme court of appeal.

3. The law

3.1 Definition of “gross income” in section 1 of the Income Tax Act

“gross income’, in relation to any year or period of assessment, means-

- (i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or
- (ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within or deemed to be within the Republic,

during such year or period of assessment, excluding receipts or accruals of a capital nature, but including, without in any way limiting the scope of this definition, such amounts (whether of a capital nature or not) so received or accrued as are described hereunder, namely-...”

Specific inclusions of “gross income”

3.1.1 Paragraph (c) of “gross income”

“(c) any amount, including any voluntary award, received or accrued in respect of services rendered or to be rendered or any amount (other than an amount referred to in section 8 (1)) received or accrued in respect of or by virtue of any employment or the holding of any office: Provided that—

- (i) the provisions of this paragraph shall not apply in respect of any benefit or advantage in respect of which the provisions of paragraph (i) apply;
- (ii) any amount received by or accrued to or for the benefit of any person in respect of services rendered or to be rendered by any other person shall for the purposes of this definition be deemed to have been received by or to have accrued to the said other person;
- (iii) to (vi) inclusive...”

3.1.2 Paragraph (d) of “gross income”

“(d) Any amount, including any voluntary award, received or accrued in respect of the relinquishment, termination, loss, repudiation, cancellation or variation of any office or employment or of any appointment (or right or claim to be appointed) to any office or employment: Provided that-

- (i) the provisions of this paragraph shall not apply to any lump sum award from any pension fund, provident fund or retirement annuity fund;
- (ii) any such amount which becomes payable in consequence of or following upon the death of any person shall be deemed to be an amount which accrued to such person immediately prior to his death;”

3.1.3 Paragraph (f) of “gross income”

“(f) any amount received or accrued in commutation of amounts due under any contract of employment or service;”

3.2 Definition of “remuneration” in the Fourth Schedule to the Income Tax Act

“‘remuneration’ means any amount of income which is paid or is payable to any person by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument, pension, superannuation allowance, retiring allowance or stipend, whether in cash or otherwise and whether or not in respect of services rendered, including—

- (a) any amount referred to in paragraph (a), (c), (cA), (d), (e), (eA) or (f) of the definition of “gross income” in section 1 of this Act;...”

4. Application of the law

CCMA and Labour Court awards will be taxed either under the general definition of “gross income” in section 1 of the Income Tax Act or they may be specifically included under paragraph (d), paragraph (f) or, if applicable, paragraph (c) of this definition.

4.1 Types of CCMA and Labour Court awards made to employees and former employees

The three broad categories into which CCMA and Labour Court awards fall, are as follows:

4.1.1 Unfair Dismissals

This mechanism is available to protect the employee against dismissal, without substantive grounds, in a procedurally unfair manner. The various elements of dismissal are categorised into substantive fairness, automatically unfair dismissals, procedural fairness and misconduct (justification for dismissal must be proven by the employer). Examples of reasons for unfair dismissal are as follows:

- Participation in trade union activities or strike action.
- Incompetence and incompatibility.
- Marital status.
- Pregnancy.
- Family responsibilities.
- Absence from work during maternity leave, illness or injury.
- Dismissal of an employee who is HIV positive.
- Incapacity or disability.
- Race, colour, gender, sexual harassment, nationality, age, politics.
- Selective dismissal and re-employment of employees.
- Religion.
- Military service.

The amounts awarded in respect of the above, including voluntary payments, in the circumstances of a claim for compensation for loss of office, termination of employment, or unfair dismissal, will fall within the ambit of paragraph (d) of “gross income”.

In terms of paragraph (d) of the definition of “gross income” any amount, including a voluntary award, received or accrued in a year or period of assessment in respect of relinquishment, termination, loss, repudiation, cancellation or variation of any office or employment or of any appointment (or right or claim to be appointed) to any office or employment, must be included in “gross income”.

The following factors will be considered in determining whether an amount will fall into paragraph (d) of “gross income”:

- There must be ‘employment’, or ‘office’ or the appointment to any ‘employment’ or ‘office’;
- There must be an amount (including a voluntary award) received by the employee;
- There must be termination of employment or the loss, cancellation, or variation of any office or employment; or
- There must be a right or claim to be appointed. In certain cases of unfair dismissal, the employee is ordered by the CCMA or the Labour Court to be reinstated within the services of the employer. The employee thereafter waives his or her right to be reinstated and receives the option of a lump sum award instead.

The following must be taken into account with regard to the meaning of ‘employment’ in paragraph (d) of “gross income”:

The dominant distinction of a person that is in employment is that of control and supervision. The master/servant relationship

is of significance. The power to supervise and control the type of work required to be conducted, the control of the productive capacity, and the power to dismiss employees lie in the hands of the employer. The employee is obliged to follow the instructions given by the employer.

4.1.2 Termination of an employment contract prior to its expiry

Where the provisions of the above-mentioned paragraph (d) are not applicable in this situation, paragraph (f) of the definition of “gross income” in section 1 of the Income Tax Act may tax “any amount received or accrued in commutation of amounts due under any contract of employment or service”. Depending on the terms of a contract of employment, a **breach** of such contract can result in amounts “due” being taxable in terms of the mentioned paragraph (f). Therefore, if an employer **breaches** a contract of employment by terminating the contract, prior to its expiry, the compensation paid by the employer will be taxed because the compensation will be received or accrued in commutation of amounts due under a contract of employment or service.

Amounts received or accrued by an employee in terms of a contract of employment, for services **to be rendered in the future**, may also fall into the mentioned paragraph (f).

In *Income Tax Case No.222 1931*, 6 SATC 148, the court held that the lump sum payment received by the employee in respect of the salary due to him in respect of the remaining period of his contract was, in fact, **income** flowing directly from a contract of service, entered into by him. The entitlement or privileges of the employee and the obligations of the employer that arise in terms of the contract of employment or service is very important when determining whether amounts fall into paragraph (f) of “gross income”.

4.1.3 Unfair labour practice

Any person who is the victim of unfair labour practice is entitled to legal protection in terms of the Constitution. The Labour Relations Act, 1995 does not provide for a general unfair labour practice jurisdiction. However, residual unfair labour practices may be described as unfair conduct during the employment relationship concerning promotion, demotion, training, suspension, failure for the provision of benefits, the failure or refusal to re-instate a former employee in terms of an agreement, or variation of employment.

The following are examples of variation of employment:

- The renewal of an employee's contract into a fixed term contract.
- A temporary employee who, after a prescribed probationary period, is made permanent.

Where an employee can prove that there is reasonable expectation that a fixed term contract will be renewed or that permanent employment can be attained, the employee can bring a claim under unfair labour practice to the courts. (*Dierks vs University of South Africa*, 1999, 4 BLLR 304(LC))

If compensation is paid in a matter relating to an unfair labour practice, **SARS will examine the facts of the case and the nature of the amounts awarded** to determine if paragraph (d) or paragraph (f) of "gross income", as discussed above, **may** be applied to the awards.

Examples in the broad categories of awards are listed in **Annexure A**.

4.2 Other applicable provisions of the Income Tax Act:

4.2.1 Paragraph (c) of “gross income”

Paragraph (c) of "gross income" may be applied to CCMA and Labour Court awards in circumstances where it can be established that the award is actually in respect of **services rendered**.

Paragraph (c) of “gross income” taxes any amount, including any voluntary award, received or accrued **in respect of services rendered or to be rendered, or by virtue of any employment or the holding of any office**. In order to determine whether the amount falls within the ambit of paragraph (c) of “gross income”, a direct link between services rendered and the payment received must be established.

Where an amount is received, in respect of past services rendered as well as for compensation for loss of office, the **dominant purpose** of the amount paid, must be determined [as was determined in *ITC No.1093*, 28 SATC 269, 1967(16)]. If it can be established that the amount has been allocated between services rendered and compensation for loss of office then the former will be included in paragraph (c) and the latter in paragraph (d) of “gross income”.

In taking all of the relevant specific inclusions of “gross income” into account, the purpose for which the payment is received must be established e.g. is the payment in respect of services rendered [paragraph (c)], or is it for the termination of employment [paragraph (d)], or is it for breach of contract of employment [paragraph (f)].

4.2.2 “Remuneration” as defined in paragraph 1 of the Fourth Schedule

CCMA and Labour Court awards, which are taxable either under paragraph (c), (d), or (f) of the definition of “gross income”, will constitute “remuneration” as defined in paragraph 1 of the Fourth Schedule to the Income Tax Act. These amounts will, therefore, be subject to the withholding of employees’ tax by the employer.

In this regard, the case of *N.C. Wentzel vs SARS*, case No. 26697/02, heard in the Transvaal Provincial Division, held that the amount awarded by the company’s major shareholder as compensation for breach of contract signed between the company’s employee and the company’s major shareholder, constituted “remuneration” , as defined in paragraph 1 of the Fourth Schedule to the Income Tax Act. The major shareholder had effectively, by virtue of its obligations in terms of the contract that it had signed with the company’s employee, become the “employer” of the affected employee and had to withhold employees’ tax from the “remuneration” that was payable to the employee.

4.2.3 The applicability of section 11(c) - deduction of legal costs

In circumstances where an employee incurs legal costs in bringing a dispute to Court, section 11(c) of the Income Tax Act permits the employee to claim a deduction of such costs actually incurred in relation to the amount of the award that will be included in his or her **income** for income tax purposes.

However, where these legal costs are subsequently recovered, as part of the award by the CCMA or the Labour Court, they will be taxed in terms of the recoupment provisions of section 8(4)(a) of the Income Tax Act.

4.2.4 The applicability of section 10(1)(x) – R30 000 exemption

CCMA and Labour Court awards that fall within the ambit of paragraph (d) of “gross income”, may be subject to an exemption of up to R30 000 in terms of section 10(1)(x) of the Income Tax Act, provided that the requirements of this section are met.

In this regard, the following requirements have to be taken into account for the exemption to apply:

- The employee or former employee must have attained the age of 55 years; **or**.
- The termination must be due to superannuation, ill health or other infirmity; **or**
- The termination must be due to the employer having ceased or intending to cease to carry on trade, **or** due to the employee becoming redundant in consequence of a general reduction in personnel or a reduction in personnel of a particular class. If the employer is a company, then this exemption will not apply to any person who, at any time, was a director of that company and that at any time held more than 5% of its issued share capital or its member’s interest.

4.2.5 The applicability of section 7A(4A) – tax rate concession

CCMA and Labour Court amounts awarded in respect of compensation because of termination of services **or** impending termination of services within five years (or any longer period as the Commissioner may approve), and which are taxable under paragraph (d) of “gross income”, may be subject to the “rating concession” in terms of section 7A(4A) of the Income Tax Act, provided that the requirements of this section are met.

In this regard, the following requirements have to be taken into account for the “rating concession” to apply:

- The taxpayer has attained the age of 55 years; **or**
- The termination of the taxpayer’s services is due to superannuation, ill-health or other infirmity; **or**
- The Commissioner must be satisfied that the termination or impending termination of the taxpayer’s services is due to the employer’s ceasing or intending to cease to carry on the trade in respect of which the taxpayer was employed; **or**
- The Commissioner must be satisfied that the taxpayer’s having become redundant is in consequence of his employer having effected a general reduction in staff or staff of a particular class; **and**
- The Commissioner must be satisfied that the circumstances of the case warrant the concession provided by section 7A(4A).

5. Tax administrative procedures

An application for a tax directive must be completed and submitted by the employer for all amounts paid to employees or former employees in respect of CCMA and labour court awards. The application form, IRP3 (a), is available on the SARS website (www.sars.gov.za) under “Income Tax”, “IT Forms”. The completed form must be submitted by the employer to the local SARS branch office where the employee or former employee is registered for income tax purposes. **Where applicable, the court judgment or settlement must be submitted with the application.**

The application form, IRP3(a) must include the following information:

- The year of assessment in which the labour court award accrued;

- The actual remuneration last received for the year of assessment; and
- A breakdown of the amount received e.g. loss of income, legal costs, damages, etc.

6. Conclusion

Amounts awarded either by the CCMA, Labour Court, or the Labour Court of Appeal in respect of labour disputes will be examined closely by the South African Revenue Service in light of the specific facts of each case.

These amounts will, in most cases, be taxed in terms of the general provisions of the definition of "gross income" in section 1 of the Income Tax Act, or in terms of the provisions of paragraph (d), paragraph (f), or paragraph (c) of that definition. Applications for directives, to determine the amount of employees' tax to be deducted from the awards, must be submitted by the employer to the relevant SARS branch office.

7. Annexures

7.1 Annexure A

Annexure A contains a list of typical awards that are taxable.

7.2 Annexure B

A comprehensive example to take the contents of this note into account is found in Annexure B.

7.3 Annexure C

This annexure deals with the taxation of awards that were made in the recent, landmark Labour Court judgment, *Ntsabo vs Real Security CC*, C 259 of 2000.

ANNEXURE A

Types of awards made to employees	Income Tax Act provision
<p>A lump sum payment received by an employee for refusal to accept a new shift system which amounted to an unfair dismissal. (<i>Fry's Metals (Pty) Ltd v NUMSA & others</i> 2003, 2 BLLR 140 (LAC)) Reason: Payment received for the termination of employment.</p>	<p>Paragraph (d) of gross income</p>
<p>An amount paid by an employer who refused to renew an employee's fixed term contract because the employee is pregnant which amounted to unfair labour practice. (<i>Solidarity obo McCabe VS SA Institute for Medical Research</i> 2003, 9 BLLR 927(LC)) Reason: Payment received in commutation of breach of contract of employment.</p>	<p>Paragraph (f) of "gross income"</p>
<p>Payment in respect of dismissing employees who refused to accept a final wage offer and locking them out. This amounts to unfair dismissal. (<i>NUMSA & others v Zeuna-Starker Bop (Pty) Ltd</i> 2003, 1 BLLR 72 (LC)) Reason: Payment received for the loss of employment.</p>	<p>Paragraph (d) of "gross income"</p>
<p>The employer retrenches employees before the sale of the business and does not inform the employees that their contracts of employment have been automatically transferred to the purchaser. The retrenchment of employees without explaining the consequences of the sale of the business is considered to be unfair. (<i>CEPPWAWU & Others v Herber Plastics (Pty) Ltd & Another</i> 2002, 1 BLLR 44 (LC)) Reason: Payment received for the termination of employment.</p>	<p>Paragraph (d) of "gross income"</p>
<p>The selection of employees for retrenchment with no prior consultation with the affected group of employees on possible alternatives can constitute unfair dismissal. (<i>Delport v Parts Incorporated Africa of Genuine Parts (Pty) Ltd</i> 2002, 8 BLLR 755 (LC)) Reason: Payment received for the termination of employment.</p>	<p>Paragraph (d) of "gross income"</p>
<p>The retrenchment of employees that unsuccessfully apply for positions during a restructuring of the business. The actions of the employer by means of filling positions may be considered to be unfair in light of the dismissed employees. (<i>Wolfaardt & another v IDC of SA Ltd</i> 2002, 11 BLLR 1127 (LC)) Reason: Payment received for the loss of employment.</p>	<p>Paragraph (d) of "gross income"</p>
<p>The employer retrenches before consultation with the employees and the unions. (<i>Mabaso & Others VS Univseral Product Network (Pty) Ltd</i> 2003, 9 BLLR 871 (LC)) Reason: Payment received for the termination of employment.</p>	<p>Paragraph (d) of "gross income"</p>
<p>The dismissal of strikers for no reason other than their participation in collective bargaining will generally be considered to be unfair. (<i>Cobra Watertech v NUMSA</i> 1995, 6 BLLR 1 (LAC)) Reason: Payment received for the termination of employment.</p>	<p>Paragraph (d) of "gross income"</p>
<p>An employee is dismissed for an alleged operational reason. (<i>Mahlati v SA Broadcasting Corporation</i> 2003, 1 BLLR 33 (LC)) Reason: Payment received for the termination of employment.</p>	<p>Paragraph (d) of "gross income"</p>
<p>Compensation paid to a prospective employee because of the failure of his prospective employer to enter into a contract of employment. <i>Silke on South African Income Tax</i> Reason: Payment received for the cancellation of employment.</p>	<p>Paragraph (d) of "gross income"</p>
<p>A lump sum payment received by an employee for the breach of a contract of employment by his employer based on the unexpired portion of the service agreement. (<i>Income Tax Case No.222 1931, 6 SATC 148</i>) Reason: Payment received in commutation of breach of contract of employment.</p>	<p>Paragraph (f) of "gross income"</p>

ANNEXURE B

Comprehensive Example

Mr. X who is 42 years of age is an employee of company Z. He has been employed by the company for 8 years. Company Z is in the process of restructuring. Employees in the middle and lower management are affected by the restructuring. Mr. X is employed in middle management. Employers have not consulted with employees or unions regarding the decision making process for the retrenchment and restructuring process. One of the senior managers had informed Mr. X that he faces dismissal. New posts are advertised before consultation with the existing staff regarding the retrenchment and restructuring process. The company informs the affected employees that they may reapply for the positions. Mr. X re-applies for his position, but he is unsuccessful. Mr. X is dismissed by the company. A new person is employed in the same capacity as Mr X, however, the job title has been changed. The job description remains the same.

Mr. X seeks an order against his company for compensation in terms of section 193(1)(c) of the Labour Relations Act, 1995. The fairness of Mr. X's dismissal is in dispute. He makes application in this regard to the Labour Court. The court finds in favour of Mr. X that the dismissal of Mr. X was procedurally unfair. The judge makes an order for compensation to be awarded to him equivalent to twelve months remuneration which amounts to R120 000. The employer is ordered to pay the costs of the application.

Company Z is now liable to award the amount after the deduction of the applicable tax due to Mr. X. Company Z must apply for a tax directive to the local SARS branch office where Mr. X is registered. The amount of R120 000 will be reduced by the tax liability determined by SARS. A copy of the Court judgment must accompany the IRP3 (a) that is submitted to the relevant SARS branch office. It must be determined whether the amount awarded is taxable and under which provisions of the Income Tax Act it is taxable.

The following facts must be taken into account:

- The amount awarded is in respect of termination of employment.
- It has been received in the 2004 year of assessment.

- Mr. X was dismissed on 15 May 2001.
- The amount awarded is made up of the last twelve months remuneration earned by Mr. X.
- The legal costs incurred by Mr. X must be paid by the employer in terms of the Court order.
- Mr. X's marginal tax rate is 30% (for illustrative purposes).
- Mr. X has not yet attained the age of 55.

The amount will be taxed in terms of paragraph (d) of "gross income". It is compensation awarded for the termination of employment. Mr. X had been in the employ of company Z for the last eight years. It must be established whether the award that will be taxed in terms of paragraph (d) of "gross income", will be subject to the exemption of R30 000 in terms of section 10(1)(x) of the Income Tax Act. Further, it must be established whether this amount will be subject to the section 7A(4A) 'rating concession' generally enjoyed by amounts that fall into paragraph (d) of "gross income". Mr X has not attained the age of 55 nor was his termination due to ill-health nor has the employer ceased trading. Furthermore, Mr. X was made 'redundant'. However, his position was immediately filled by a new appointee. Therefore, it is apparent that the termination of his employment was not due to redundancy. The provisions of sections 10(1)(x) and 7A(4A) of the Income Tax Act will, therefore, not apply to the compensation award received by Mr. X. This means that the award will not be subject to the 'rating concession' or to the exemption of R30 000. The full amount of R120 000 will be subject to tax of 30%. The tax will be withheld by Company Y and the remaining portion of the award will be paid to Mr. X.

The legal costs actually incurred by Mr. X, in relation to the taxable amount of the award, will be allowed as a tax deduction. However, since Company Z was ordered to pay these legal costs, the recovered amounts that were allowed as a tax deduction will be taxed in Mr. X's hands. It follows that any portion of the legal costs that was not allowed as a tax deduction will not be taxed. This effectively means that the legal costs recovered from Company Z will be tax-neutral in the hands of Mr. X.

ANNEXURE C

Labour Court Judgment: *Ntsabo vs Real Security CC, C 259 of 2000*

In this recent, landmark case, the Court was satisfied with the employee's claim that she had been constructively dismissed.

What makes this case unique is that the employee's application for a sexual harassment claim was also successful in the same Court. In this regard, it was ruled by the Court that:

- The employer had failed to protect the employee after it had received numerous complaints that she was being sexually harassed by her supervisor.
- The employer had contravened sections 6(1) and 6(3) of the Employment Equity Act, 1998 that deals with sexual harassment.
- The employee's privacy and constitutional rights had been violated.

The court ordered that **compensation for unfair dismissal and damages for sexual harassment** be paid to the employee. The compensation and damages are made up as follows:

- R12 000 for unfair dismissal;
- R20 000 in respect of future medical costs (psychological counselling);
and
- R50 000 for damages in respect of the employee's impairment of dignity.

The tax implications for the amounts awarded are as follows:

- **R12 000 for unfair dismissal**
The amount awarded in this respect will be taxed under paragraph (d) of "gross income", as dealt with above in paragraph 4.1.1.
- **R20 000 in respect of future medical costs (psychological counselling)**

In view of the facts of this particular case, this payment will not be taxed under paragraphs (c), (d), or (f) of the definition of "gross income" in section 1 of the Income Tax Act.

- **R50 000 for the employee's impairment of dignity**

In view of the specific facts of this case, this amount will not be taxed under paragraphs (c), (d), or (f) of the definition of "gross income" in section 1 of the Income Tax Act.

The legal costs actually incurred by the employee, in relation to the taxable amount of the award, will be allowed as a tax deduction. However, since the employer was ordered to pay these legal costs, the recovered amounts that were allowed as a tax deduction will be taxed in the employee's hands. It follows that any portion of the legal costs that was not allowed as a tax deduction will not be taxed. This effectively means that the legal costs recovered from the employer will be tax-neutral in the hands of the employee.