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Tax Implications of CCMA Awards, Labour Court Orders or Settlements

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Often employment law disputes at the Commission for Conciliation, Mediation and Arbitration ("the CCMA") or the Labour Courts are resolved by way of an award of compensation in favour of an aggrieved party.

Disputes are also often resolved by way of a financial settlement. Section 5(3) of the Labour Relations Act 66 of 1995 (as amended) ("the LRA") makes provision for parties to settle any labour dispute by way of agreement.

In the CCMA, settlement agreements are mostly concluded during the conciliation stage of the proceedings. Typically, an employer-party agrees to pay an employee-party an amount of money to resolve the dispute.

An important factor which should not be overlooked is whether the settlement payment is net of employee's tax ("PAYE"), alternatively whether PAYE must be deducted by the employer prior to making any payment. An omission to deal with this could lead to further disputes.

This article does not deal with settlement agreements concluded to settle dismissals for operational requirements or mutual termination agreements concluded during a retrenchment exercise, as these settlements fall under a different tax regime.

The South African tax implications of CCMA awards, Labour Court orders or settlements in the context of unfair dismissals and unfair labour practices have been considered in our courts.

The Labour Court in *Penny v 600 SA Holdings (Pty) Ltd* (2003) 24 ILJ 967 (LC) held the following:

"An employer has a statutory obligation in terms of the Income Tax Act to deduct the required tax from any remuneration which it pays to an employee."

The Labour Court in *AL SHA Trading Pty Ltd vs Neil Harrison, the CCMA and the Sheriff of the High Court*, Germiston, J235/15 confirmed that if the settlement agreement or award is silent on whether the award is net of PAYE, the amount will be gross of PAYE and will be subject to lawful PAYE deductions in the hands of the employee-party.

A resident's "gross income" as defined in section 1(1) paragraph (c), (d) and (f) of the Income Tax Act 58 of 1962 ("the ITA"), includes:

- *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; ...*
- *any amount received or accrued in commutation of amounts due under any contract of employment or service."*

"Gross income" includes, in terms of paragraph (c), any voluntary award, received in respect of services rendered, or by virtue of any employment, if it can be established that there is a direct link between the services rendered and the payment received.

The term "remuneration" is defined in the Fourth Schedule to the ITA, to include any amount referred to in paragraph (c), (d) or (f) of the definition of "gross income".

As such, SARS has confirmed that CCMA and Labour Court awards (which include settlement awards) will be taxed either under the general definition of "gross income" in section 1 of the Act or they may be specifically included under paragraph (d), paragraph (f) or, if applicable, paragraph (c) of this definition.

What should be noted is that the purpose for which the settlement award is received (unfair dismissal or an unfair labour practice) will ultimately determine under which paragraph of the definition of "gross income" the settlement award will be included.

Consequently, amounts 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 and will therefore generally be subject to the withholding of PAYE by the employer.

Paragraph 2 of the Fourth Schedule to the Act provides that every resident employer who pays or becomes liable to pay any amount by way of "remuneration" to any employee shall, unless the Commissioner of SARS ("the Commissioner") has granted authority to the contrary, deduct or withhold from that amount, by way of PAYE an amount to be determined by the Commissioner. Consequently, an employer is legally obligated to withhold PAYE from the CCMA or Labour Court settlement amount.

A South African resident employer is legally required to withhold PAYE from amounts which constitute remuneration and therefore must withhold PAYE from a CCMA award, Labour Court order or settlement amount received by an employee in relation to an unfair labour practice or unfair dismissal.

If the award, order or settlement relates to an unfair labour practice, SARS will examine the facts of the specific case and the nature of the amounts awarded, to determine if paragraph (f) or (d) of the definition of "gross income" should be applied to the amount. If the award, order or settlement amount relates to an unfair dismissal, the amount falls within the ambit of paragraph (d) of "gross income".

Alternatively, paragraph (c) of the definition of "gross income" may be applied to the settlement awards, in circumstances where it can be established that the award, order or settlement amount is in respect of services rendered, rather than the termination of the services.

If the amount falls under paragraph (f) or (c) of the definition of "gross income", in the context of unfair dismissals, the employer is obliged to withhold from the award, order or settlement an amount determined by the PAYE deduction tables prescribed by SARS.

If the amount relates to an unfair dismissal and therefore falls under paragraph (d) of the definition of "gross income", the employer is obliged to apply to SARS for an income tax directive to ascertain the amount of PAYE that must be withheld from the award, order or settlement amount. The determination as per the directive is final and binding on the employer.

Parties to a labour dispute that is settled by way of agreement, specifically an agreement in terms of which an employer-party pays an employee-party an amount of compensation as a settlement amount, should therefore take care to make sure that everyone is on the same page in respect of the actual after-tax amount which will be paid to the employee-party.

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