

ADVANCES AGAINST GRATUITY COMPLICATE PAYE: By Jonathan Hore

Some employers are so concerned about their employees' welfare and they come up with a number of incentives to take good care of their employees. One of the ways in which employers try to incentivise employees is granting them advances against gratuities. I want to analyse how this well-intended initiative may complicate tax compliance and possibly result in unexpected tax liabilities. In this article, words importing the masculine shall be deemed to include the feminine.

Enter gratuity

A gratuity is usually availed to employees who are not pensionable as a way of building up some funds upon which they may live on after the end of their contracts. The gratuity accrues on a monthly basis but it is paid at the end of a contract. It is common that employees may be entitled to gratuity in 2 or 5 year intervals. The Economic Times states that, 'a person is eligible to receive gratuity only if he has completed ... years of service with an organisation. However, it can be paid ... at the death of an employee or if he has become disabled due to an accident or disease.' This quote brings out the most critical aspect of a gratuity, being that it is a termination payment. It becomes payable when the contract expires.

Enter advances

The big problem with gratuities is that some employers avail them in advance, before the end of an employees' contracts. This may be done yearly or in other intervals chosen by the employer. You may want to know that a gratuity is only taxable to the extent of 66.67%. In other words, 33.33% is exempt from tax.

The challenge with advances against a gratuity is that the employer will be allowing the employee access to an amount which is only, in the strictest terms of the arrangement, available at the end of the contract. Some employers still exempt 33.33% even when they advance the gratuity before maturity date. Others defer the taxation to the end of the contract, meaning that the advances are not taxed.

Here is the problem

The problem with the above arrangements is that it distorts the whole essence of gratuity, which is only accessible at the end of a contract. Further, section 10 of the Income Tax Act stipulates that, 'for the purposes of this Act, an amount which accrues to a person shall be deemed to have accrued - (a) in the case of employment, at the time it is - (i) received by him or her.' This is the root cause of the problem, being that employment income, including a gratuity, is supposed to be taxed as and when it is 'received' by the employee.

In other words, the employee becomes liable for PAYE on the advance as and when payment is made and not at the end of the contract as is common practice amongst those who give gratuity advances. This exposes employers who pay the advances frequently or regularly without deducting PAYE as the Income Tax Act states that tax becomes due when the advances are availed to employees.

Before I check out

Let me be frank with you and state that I haven't seen anything from BURS which precludes employers from allowing employees to access the gratuities in advance but my analysis of the Income Tax Act above revealed that the whole arrangement complicates the PAYE for the employer. Remember that PAYE is the responsibility of the employer and should BURS detect any mistakes, it penalizes the employers and not employees. Bear in mind that BURS

has the liberty to charge penalties of up to 200% when non-compliance with tax is noted, especially through an audit.

Some employers even go to the extreme and pay gratuity monthly and still exempt 33.33% of the amount from tax. That certainly is not a gratuity and the exemption must not apply. So, how different is the annual or bi-annual advances against a gratuity from the monthly payments that others do? The long and short of the matter is that it is advisable for employers not to tamper with gratuities if not prepared for tax queries.

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.