

Unfair Dismissal Compensation Is Taxable: By Jonathan Hore

It often happens that employees are unfairly dismissed, which results in the matters spilling into the Courts of Law. The question which arises is whether an amount which a court determines as due to the affected employee is subject to Pay As You Earn (PAYE) or employees tax, given that the employer would have, in most instances, terminated the employment contract. Another burning matter arises from the fact that the courts determine that the former employee must be paid a specified amount without mentioning whether or not the compensation is inclusive of PAYE. This throws employers into a quandary occasioned by the courts' directives which do not determine how PAYE must be treated. I will analyse this matter in detail below. In this article, words importing the masculine shall be deemed to include the feminine.

Why PAYE?

It is common knowledge that employees suffer PAYE on remuneration paid by employers. But when someone is dismissed from work, they cease to be an employee, in the strictest meaning of the word. Therefore, it would make sense to conclude that even if a court rules that the former employer pays compensation to the said employee, no PAYE would be applicable on such amounts. This seemingly reasonable analogy is derailed by the fact that the Income Tax Act defines 'employee' as including a 'former employee.' Technically, that extends the employer-employee relationship beyond the contract of employment. Having made that observation, we need to analyse whether PAYE must be deducted when a court of law directs that the employer pays the ex-employee a certain amount.

Court's directive

Most courts simply issue a ruling which states that the employer is obligated to pay a specified amount of money for unfair dismissal. Armed with the ruling from the court, most ex-employees demand payment of the stated amount in full, without deduction of PAYE. This usually results in conflicts between the ex-employee as employers take it that the compensation must be subjected to PAYE. Courts of law deal with the issue at hand, being that of amounts claimed as compensation and PAYE is not usually mentioned in the issues under litigation, resulting in the above-mentioned contention.

The answer

I established above that 'employee' brings into its ambit an 'ex-employee,' which clearly suggests that former employees must also pay PAYE from the amounts determined by the courts. But is the compensation 'remuneration' subject to PAYE? Another look at the law will help us solve this matter. The Income Tax Act defines, 'remuneration' subject to PAYE as including, 'any amount accrued to an employee by way of ... compensation.' Well, that solves the puzzle. First, an ex-employee is supposed to be treated as an employee and compensation paid to an x-employee must therefore be treated as remuneration subject to PAYE. The reason why the courts do not make a determination on PAYE is that they are in most instances only requested to deal with whether or not affected employees must be compensated for unfair dismissal.

Don't forget this

Given the above, employers are advised to put forward to the courts the fact that any compensation determined in favour of an employee must be subject to PAYE. If the courts are silent about PAYE, it is given that employers must deduct the tax and remit it to BURS. Employers therefore need to play their cards close to their chests in such employment tussles.

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 or know about our 9 Tax ebooks, send me a text on the cell number below.