

RETRENCHMENT PAY THAT CONSTITUTES PAYMENT FOR LOSS OF EMPLOYMENT IS NOT TAXABLE

PREAMBLE

1. IRAS has received a number of enquiries from both employers and individuals, seeking clarification on the tax treatment of payments received by an employee who is retrenched.
2. This Practice Note explains the tax treatment of payments received by an employee who is retrenched.

ADMINISTRATIVE PRACTICE

3. Retrenchment payments that are made to compensate for the loss of employment are not taxable to the retrenched employee because they are capital receipts. This tax treatment applies even if the payments to compensate for the loss of employment are provided for in the contract of service or collective agreement, or are computed based on the number of years of service with the employer.
4. However, employers often include payments for other purposes when paying out retrenchment benefits. Such other payments are taxable to the employees. Examples are salary in-lieu of notice and gratuity for past services. These other payments are not payments received by the retrenched employees as compensation for loss of employment. They are payments for services. They constitute gains or profits from employment and are, therefore, liable to tax under section 10(1)(b) of the Income Tax Act.
5. Whether payments are made to retrenched employees as compensation for loss of employment or not is largely a question of fact. IRAS will examine all the facts and circumstances giving rise to the payments to determine the nature of the payments in each case. The nature of the payments does not simply depend on, and hence is not affected by, the description ascribed to the payments by the employers.
6. Appendix A provides an example showing the different types of payments an employee may receive upon retrenchment and the taxability or otherwise of each type of payment.

Types of payments an employee may receive upon retrenchment

<u>Types of payments</u>	<u>Amount</u>	<u>Tax treatment of payments</u>
Salary	\$ 10,000	Taxable
Allowances	\$ 850	Taxable
Pro-rated bonus	\$ 6,200	Taxable
Commuted leave pay	\$ 2,800	Taxable
Retrenchment benefits:		
Payment in lieu of notice	\$ 4,200	Taxable
Gratuity for past service	\$ 10,510	Taxable
Compensation for loss of employment	\$ 36,750	Non-Taxable ¹
Total	\$ 71,310	

¹ In determining whether the payment is made for the compensation of loss of employment or not, IRAS will examine all the facts and circumstances giving rise to the payment. Where the facts and circumstances clearly show that the payment is solely made to compensate the employee for the loss of employment, the payment is not taxable to the employee. However, where the facts and circumstances show that the payment is, say, made in appreciation of the employee's past services, the payment is taxable to the employee. This is so regardless of how the employer may have described the nature of such payment.