



Department of Taxes

DEPARTMENTAL GUIDANCE NOTE ON TERMINAL GRATUITIES - EXPATRIATE EMPLOYEES

1. INTRODUCTION

The purpose of this note is to set down the general practices followed in relation to exemption from tax of payments of bonus or gratuity paid to expatriate employees on termination of contracts of employment, subject to the provisions of section 132 et seq. (close companies).

The law relating to taxation of gratuity received by expatriate employee has been changed by Income Tax (Amendment) Acts 1999 and 2000. DGN deals with both the contracts commencing before 1.7.1999 and those contracts commencing on or after 1.7.1999.

The terms of the Note have no force in law and do not restrict any taxpayers' rights under the Act, in particular, the right of objection or appeal.

In the case of expatriate employees whose contract Commenced on or after 1.7.1999, the relevant provisions are in Section 31 (11) of the Income Tax Act., 1995 (Paragraph 5(b) of Taxation (Amendment Act) 1999 and and paragraph 4(c) of Income Tax (Amendment) Act 2000)

2. General

In the case of expatriate employees whose employment commenced before 1.7.1999, The relevant provisions are in paragraph (xviii) of Part II of the Second Schedule to the Act. The gratuity received by an expatriate employee under a contract of employment commencing before 1st July 1999 would be exempt under paragraph (xviii) of Part II of Second Schedule subject to fulfillment of conditions laid down by the Commissioner of Taxes.

In the case of gratuity received by an expatriate employee under a contract of employment commencing on or after 1st July 1999, one third of such gratuity will be exempt and balance two third will be taxable subject to the amended by Income Tax (Amendment) Act 2000.

Subject to any special arrangements agreed with any individual employer, under current legislation and practice gratuities payable on termination of employment may be exempted (either fully or in part depending on whether the contract commenced before or on or after 1.7.1999) from income tax provided the under noted conditions are met:

- i) The employee must not be a Citizen of Botswana;
- ii) The gratuity must be due in the terms of a written contract or employment;
- iii) The gratuity must be due only on termination of the contract or employment;
- iv) There must have been a continuous period of not less than two years employment under the contract, in Botswana, at termination;
- v) The employee must not have accrued any benefit under any employer's retirement benefit arrangement for or during the period of the contract;
- vi) The amount of gratuity to be exempted will not exceed.
 - a) In the case of an employee's first contract with the employer – 25%, and
 - b) For a second contiguous contract – 27 ½ and
 - c) For a third and subsequent contiguous contracts – 30% of the salary paid under the appropriate contract; and
- vii) A directive must be obtained from this Department (form ITW 4) before payment of the terminal gratuity in the case of contracts which commenced before 1.7.1999. **In the case of contracts commencing on or after 1.7.1999 employer must withhold tax from payments in accordance with Section 31(11) as amended by Income Tax (Amendment) Acts 1999 and 2000 and DGN and instructions issued by the Commissioner of Taxes. Further to that the employer should obtain form ITW 6A (CONFIRMATION OF TAX OWED) from our Business and Investment division.**

Where the amount of the gratuity exceeds the appropriate percentage of salary, but otherwise complies with the conditions for exemption, only the excess is to be taxed.

Where condition (iv) above is not met, and the employer or employee claims special consideration, the case is to be referred to the Commissioner with a written submission, supported by written evidence as necessary.

Some of the requirements are mandatory and some subject to "Commissioners opinion" as indicated in the following paragraphs.

3. Mandatory provisions

3.1 General

These provisions are seen, as requiring that a payment considered for exemption must be:

- (a) due from an employer to his employee;
- (b) due to an expatriate employee;
- (c) due in terms of a written contract of employment
- (d) due on bonafide termination of the employment; and
- (e) Due as bonus or gratuity.

3.2 Payer

The employer must, himself, have the obligation to make the payment.

A condition that the payment accrues from some other person will preclude consideration of the payment in terms of paragraph (xviii) of Part II of Second Schedule and Section 31(11) of the Income Tax Act and this will apply whether or not the employer acts as a conduit.

3.3 Citizenship

The right of the payment must arise to a non-citizen. Where, however, the employee has become a citizen of Botswana during the course of the employment a portion will be considered for exemption. That portion considered will be related to the period served, under the relevant contract, as a non-citizen.

3.4 Contract

The contract under which the payment is made must be in writing signed by both parties and is expected to exist at the time the employment commences.

In this connection it is known that certain employers have printed standard conditions of employment. In such cases a written offer of appointment referenced to those conditions and accepted, in writing, by the employee is considered to meet this requirement.

It is understood that contract conditions may be changed during the contract period. Such changes might not be acceptable where there is a retroactive effect and, especially, will this be the case where income, which accrued prior to the change, is converted to terminal gratuity or bonus. **Any contract which has been amended to extend the term of the contract beyond 1.7.1999 and which would otherwise have expired before 1.7.1999 would be treated as new contract commencing on or after 1.7.1999.**

Where a contract provides for the retention by the employer of a portion of remuneration, which has already accrued, the amount so withheld or set aside is not terminal payment to be considered for exemption.

3.5 Termination

The employment with the employer must be coming to an end in this regard a contract for a fixed period is considered to be an employment which terminates at the end of the contractual period.

A renewal of a contract in terms similar to a contract already completed is read as a new employment.

A contract that is extended is seen as terminating at the end of the period in which it would have terminated but for the extension and the contract period after that date is treated as new contract. For instance, if a contract which would have terminated on 30th June 1999 has been extended beyond that date, the contract is deemed to have terminated on 30th June 1999 and the service after that date would be treated as under a new contract. Any gratuity relating to the period after 1.7.1999 in cases of extension of contract will be taxable under section 31(11).

3.6 Bonus or gratuity

These items are seen as rewards in respect of the whole period of the employment. They must also to be of a non-recurrent nature before being considered for exemption. A payment of an annual bonus falling due on termination is not seen to fall within the exemption provisions nor is a payment of compensation similarly falling due.

4. Provisions subject to Commissioners opinion

4.1 General

Matters following to be decided under this head are the reasonableness of the amount of the payment in relation to:

- (a) the period of employment;
- (b) the nature of the employment;
- (c) the salary payable; and
- (d) The measure of retirement benefits generally prevailing.

In expressing an opinion it is necessary that the Commissioner apply his mind to the point in question. Whilst this might imply that each case requires separate consideration it is thought that the rules detailed in the following paragraphs are capable of general application having in mind that the rights of objections and appeal remain available.

4.2 Period of employment

A minimum period of two years service in the employment or under the contract is looked for.

Terminal leave taken is viewed as part of the period of service but, it must be in mind that, where such leave is taken then the employee remains subject to all conditions of the contract and that the date of termination (i.e. the due date for payment of the gratuity) will be the last day of the leave period.

4.3 Nature of employment

In practice employment of any nature are admitted. However there should be relationship of employer and employee and exercise of independent professional services by a person under a contract not amounting to employment are not treated as 'employment'.

4.4 Salary payable

Amounts considered for exemption are based on salary only. Those parts of any terminal payment based on say bonus; commission; overtime etc. are not considered. However, leave pay or leave entitlement sold may be included to the extent that the payments are based on salary alone. Salary for this purpose includes the car allowance but excludes any contract supplementation or other allowances.

Amounts, which will be exempted if all other requirements are met, are:

- (a) 25% of contractual salary earned in the period of a first contract.
- (b) 27 ½ of contractual salary earned in the period of second continuous contract; and
- (c) 30% of contractual stated in an employment contract as being payable "free of tax" or similarly described, is to be "grossed up" for the purpose of computing the limits stated above.

For contracts terminating on or after 27th March 1986 these percentages may be increased to take account of adverse rates of exchange of the Pula and information on this point is passed to employers from time to time. **In the case of contract commencing on or after 1.7.1999, the amount of gratuity paid (in cases where gratuity is adjusted for exchange rate fluctuation) in excess of the percentage stated in the table prescribed by the Ministry of Finance shall be fully taxable. In the case of contracts commencing or after 31st March 1999 but before 31st March 2000, the maximum percentage of gratuity eligible for exemption (in full or in part depending on the date of commencement of the contract) will be 31.32% for first contract, 34.45% on second contract and 37.58% for third and subsequent contracts subject to exchange rate being not less than 7.50 Pula for a Sterling pound 15 days before the termination of contract.**

4.5 Retirement benefits

A terminal bonus or gratuity payable to an employee who accrues a retirement benefit for the same period of employment will not be exempted, where that benefit accrues from his employers retirement benefit scheme.

5. Tax Directive

There is one further statutory requirement, and that before making payment of a terminal bonus or gratuity a Tax Directive must be obtained from the Department. **In the case of contract commencing on or after 1.7.1999, it will not be necessary for the employer to seek a directive from the Commissioner provided tax has been deducted from the gratuity in terms of section 31 (11) and in accordance with this Guidance Note. If the employer is in doubt, he may seek a directive from the Commissioner.**

Request for a directive is to be made not less than 15 days before the due date for payment. That request is to be made on Form ITW6, which can be obtained from the Department. The request is required to cover any other terminal lump sum payments e.g. cash in lieu of leave entitlement and recurrent items, such as salary, remaining to be paid.

The Directive will be notified, in writing, on Form ITW4 to both employer and employee and will indicate the amount of tax to be withheld from the lump sums and recurrent items advised.

It is emphasized that this Directive must be obtained **in cases where contract of employment commenced before 1.7.1999** and any employer who makes terminal lump sum payments without a Directive is in default, this, whether or not he withholds any tax from those payments.

6. As noted earlier, rights of objection and appeal remain with any aggrieved employee when assessed.

Additionally where, for reasons peculiar to any one employee or employer, the matters which are subject to discretion are thought to be inappropriate or the conditions set down can not be met, further consideration will be given to any such case on written application setting down those reasons.

Finally, it is pointed out, that a contract for employment is one between employer and employee and that the terms of this Note neither lay down the contractual requirements nor intervene in employer/employee relationship.

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