



Interpretations, Rulings & Opinions Committee Paper
I.R.O.C Paper. (Volume 2; Issue 1 Issued 2001, March.)

Re: Treatment of Gratuity under the Income Tax Termination of Employment Order

In recent times there has been great concern regarding the taxability in respect of the payment of gratuity. Please follow the guidelines below:

Section 5(1)(c)(4)(a) of the Income Tax Act, stipulates that any lump sum paid out of the Consolidated Fund, or any other fund or account designated by the Minister as being a public fund or account, should not be taxed.

1. What is a Lump Sum?

Lump sum is defined under the Termination of Employment Regulations (1971) as *"any payment, other than a periodic payment"*.

2. When is gratuity not taxable?

(a) Gratuity would not be taxable if the individual the individual is receiving a gratuity in lieu of pension and is a lump sum paid from the consolidated fund or any other fund designated by the Minister as being a public fund or account and is not a periodic payment.

(b) If not qualified for (a) above, and the individual has three or more years service and employment is terminated and is receiving a gratuity or terminal payment, in this case a part or all of his gratuity/terminal payment would be taxed free but would be calculated by using the formula below:

The tax free portion is the average salary for the last three (3) years multiplied by two and a quarter ($2\frac{1}{4}$), multiplied by years of service divided by thirty three and one third ($33\frac{1}{3}$).

Any amount exceeding the tax-free portion is emoluments and should be taxed accordingly.

- (c) In circumstances, where gratuity is paid out of the Consolidated Fund at the end of a contract period, this sum is allowed tax-free even if a new contract is entered into and commences immediately.
- (d) If (c) above is not applicable, but the employee has three (3) or more years service then the formula in (2b) above would be applicable.

3. When is Gratuity Taxable?

Gratuity is taxable when:

- (a) the Commissioner responsible for Income Tax identifies the amount paid as a periodic payment.
- (b) Payment is made from the annual budget. Payments by government entities/statutory bodies out of their annual budgets do not qualify as being "paid out of the Consolidated Fund" as provided in section 5(1)(c)(iv)(A).
- (c) Sums, which are charges on the fund, are usually specifically made in legislation. Gratuity paid at the end of a contract but there is no termination of employment that is employment continues but the contract is extended.
- (d) Gratuity is paid and 2(a) above is not applicable and individual has less than three (3) years service. The formula in 2(b) above which is used to compute tax-free gratuity or terminal payment does not apply, as the employment must



have lasted for at least three (3) years for this formula to be applicable.¹

¹ **This bulletin is only a guide, and is not a substitute for the Income Tax Act and other relevant legislation.**