Retrenchment benefits and packages in South Africa

Retrenchment benefits may seem few and far between

You can make sure that you know your legal rights in terms of what retrenchment benefits are due to you. Be sure to structure your final severance package optimally in terms of income tax and also ongoing personal issues such as life cover and medical aid.

What is retrenchment?

For an answer to the question ‘what is retrenchment’, you need to look at Section 189 of the Labour Relations Act (LRA). The LRA permits employers to dismiss employees for operational requirements. This is the process of an employer dismissing one or more of its workforce due to underlying operational activities, which are negatively affecting the viability of the business.

What is the retrenchment process in South Africa?

The employer needs to comply with a stringent set of requirements when deciding to begin the retrenchment process in South Africa. Below are some of the key information your employer will need to provide you with:

- The employer needs to issue a notice of retrenchment to all affected employees
- Reasons for the dismissal as well as what alternatives the employer considered before implementing dismissals
- The method the employer used to select which employees are to be dismissed
- Possibility of future re-employment should things improve

Minimise your financial worries by knowing your rights. Get sound retrenchment financial planning advice to grow your retirement capital, rather than give a large portion of it away to the taxman.

What payments can you expect as retrenchment benefits?

- Severance pay – this should be at least one week’s remuneration per completed year of service. Remuneration is calculated including basic salary and payments in kind.
- Outstanding leave must be paid out in full.
- Notice pay may vary depending on your employment contract.
- In the absence of a contract, you are entitled to notice pay as follows:
  - If you have been employed for 1-4 weeks: 1 week’s notice pay
  - If you have been employed for 4 weeks-1 year: 2 weeks’ notice pay
  - If you have been employed for more than a year: 4 weeks’ notice pay

Depending on your employment contract again, you may be entitled to a pro rata payment of your annual bonus and the balance of any pension or provident fund benefits.

Tax issues for retrenchment benefits

In South Africa, the taxman now uses the retirement tax tables for severance benefits, which are taxed (in aggregate for your lifetime) as follows:
<table>
<thead>
<tr>
<th>Benefit</th>
<th>Rate of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>R0 – R500 000</td>
<td>0% of benefit</td>
</tr>
<tr>
<td>R500 001 – R700 000</td>
<td>18% of benefit over R500k</td>
</tr>
<tr>
<td>R700 001 – R1 050 000</td>
<td>R36,000 + 27% of benefit over R700k</td>
</tr>
<tr>
<td>R1 050 001 and above</td>
<td>R130,500 + 36% of benefit over R1,050k</td>
</tr>
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Therefore, if you have previously received severance pay, or cashed in a pension or provident fund, or received a cash lump sum from a retirement fund these will be aggregated when determining the relevant tax bracket for your current severance package pay out. The timeline of these lump sums is extremely important as they impact on the tax table above. It is, therefore, critical to seek financial planning advice to assist you with the severance pay calculation.

How to reduce tax on retrenchment benefits

Lump it all together

If there is an option with regard to structuring your retrenchment package, please note that up-front lump sum payments may offer preferential tax relief. You should consult a professional adviser to review the options.

Top up for retirement

Using a portion of your severance benefit towards a retirement fund could potentially save you some income tax. Your financial planner will be able to assist you with this calculation.

Guard the retirement portion of your retrenchment benefits

You have three possible options with your pension or provident fund payout.

1. Spend it
   This is the worst possible option. Firstly, you will make a large, ‘voluntary’ contribution to the taxman’s coffers and secondly, in all likelihood you will never build the capital up again.

2. Invest via a retirement annuity
   With this option, you cannot withdraw any of the capital until you reach the age of 55. This has the advantage of locking in your retirement savings and you pay no tax on the transfer.

3. Invest via a preservation fund
   This is similar to a retirement annuity, but such a fund allows a single withdrawal of up to 100% of the amount before the age of 55. Again, you pay no tax on the transfer.

What else can you negotiate in respect of retrenchment benefits?

Find out about your medical aid membership and group life cover. Can you take it over in your personal capacity until you find new employment? As you get older, effective, cost-effective medical and life insurance cover can be difficult to get again, so it is worth sticking with existing policies if at all possible.
In summary: retrenchment benefits

Severance, notice and leave pay are specified in terms of South African labour law, along with the basis of their calculation. Bonuses and pension benefits payments are subject to your employment contract.

To avoid paying unnecessary tax on your retrenchment benefits, structure your package according to the guidelines above. In addition, have your accrued pension savings transferred directly into a retirement annuity or preservation fund.

Negotiate to maintain any medical aid or life insurance contracts if possible to lock in favourable premiums.

A Certified Financial Planner® professional can offer valuable advice on maximising your retrenchment benefits. Visit your financial planner for advice about all the possibilities BEFORE your retrenchment package is finalised.

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