

VOLUNTARY SEVERANCE PACKAGES (VSP) AND RETRENCHMENT: WHAT ARE YOUR OPTIONS?

If you have been offered a VSP or are in the process of being retrenched, it is crucial that you understand the options available to you and the long-term consequences of the options you choose. The choices you make should result in the least amount of tax, the greatest flexibility and access to your funds and a transfer of as many other benefits available to you as possible. Firstly, however, it is important to understand what amounts or benefits may become available at retrenchment and what options are available for each of those amounts or benefits.

The amounts you can expect to receive at retrenchment can be divided into three categories:

1. normal income
2. severance benefits
3. retirement fund benefits

1. Normal Income

- Amounts received as normal income typically include your last salary, or notice pay, for the notice period that your employer is contractually obliged to give you.
- If you are a member of a deferred compensation scheme, and you choose to have your deferred compensation policy paid out or ceded to you at retrenchment, the amount paid or the value of the policy will also constitute normal income in your hands.
- Normal income is taxed at your marginal rate (between 18% and 45%) and the net after-tax amount is paid over to you. You have no option to transfer your normal income to an approved retirement fund without paying tax.

Example:

John works for ABC (Pty) Ltd and earns R20 000 per month. Due to the operational requirements of ABC, John is retrenched (or is offered a VSP). In terms of the contract of employment between ABC and John, ABC is required to give John two months' notice before terminating his employment. However, instead of giving notice and requiring John to work a further two months, ABC pays him two months' notice pay and John receives a further R40 000, which will be taxed at his marginal rate.

2. Severance Benefits

- Severance benefits include any lump-sum amount an employee receives from their employer for relinquishing, terminating, losing, repudiating, cancelling or varying their employment if:
 - the employee has reached the age of 55; or
 - this is due to the employee becoming permanently disabled; or
 - this is due to the employer stopping or intending to stop the trading activities for which the employee was employed; or
 - this is due to the employee having become redundant due to the employer reducing staff numbers in general or reducing the numbers of certain types of staff.
- Severance benefits are taxed according to the retirement lump sum tables, and are taxed cumulatively together with all retirement fund lump-sum benefits received and previously received (see tables and example below).
- Even though severance benefits are taxed according to the retirement lump-sum tables, they are not retirement funds and cannot be transferred to an approved retirement fund, like a preservation fund, without paying tax.
- There is also no option to only take a portion in cash. The full severance benefit is taxed and the net after-tax benefit is paid out.

Example:

Apart from the notice pay that John is offered, he is also offered half a month's salary for every year that he has worked for ABC. He has worked for ABC for six years and is therefore offered three months' salary. John has never received any other severance benefits or retirement lump sum benefits. If he decides not to take any of this pension money, he will receive R60 000 (R60 000 taxed at 0% according to the retirement lump sum table set out below). If he decides to take a portion of the pension money in cash, the R60 000 severance benefit plus the amount taken in cash from his pension fund will be taxed according to the retirement lump sum table.

3. Retirement Fund Benefits

- A retirement fund benefit is the value of your pension– and/or provident fund at retrenchment.
- Your options are:
 - to take the full benefit as a lump sum cash amount
 - to transfer the full benefit to a qualifying retirement fund, or
 - to take a portion of the benefit as a lump sum and to transfer the balance to a qualifying retirement fund (the rules of some retirement funds do not allow this option).
- Any amount taken as a lump sum is taxed according to the retirement lump-sum tables and is taxed cumulatively together with any severance benefits or retirement lump-sums taken before.
- Any amount transferred to an approved retirement fund is transferred tax free.
- If you are a member of a pension fund you can transfer a portion (up to 100%) of your retirement fund benefits tax free to:
 - your new employer’s pension fund
 - a pension preservation fund (like the PSG Wealth Pension Preservation Fund), or
 - a retirement annuity (RA) fund (like the PSG Wealth Retirement Annuity Fund)
- If you are a member of a provident fund you can transfer all or a portion of your retirement fund benefits tax free to:
 - your new employer’s provident fund or pension fund
 - a provident preservation (like the PSG Wealth Provident Preservation Fund) or pension preservation fund
 - an RA
- Benefits transferred to your new employer’s pension- or provident fund can only be accessed again when you leave that employer or retire. Benefits transferred to an RA can only be accessed on emigration or at age 55 but benefits transferred to a pension preservation or provident preservation fund can be accessed once prior to retirement (your once-off withdrawal). If you need to access your funds in future, the once-off withdrawal from preservation funds offers you the flexibility which other funds do not offer. However, to deter members from making the once-off withdrawal, any amount withdrawn is taxed at less favourable lump-sum withdrawal rates.

Example:

John is a member of ABC’s Pension Fund. His fund value is R 500 000. If he decides to take R 500 000 as a lump sum, this amount plus his severance benefit of R60 000 will be taxed according to the retirement lump sum table below.

He will receive R549 200 (R 560 000 – R10 800).

If he decides to transfer his pension fund to the PSG Wealth Pension Preservation Fund, he will not pay any tax on the transfer and can invest his R 500 000 to provide for his retirement one day. He will still receive the R 60 000 severance benefit.

Also find out whether you have a conversion option available on your group life cover and, if so, the timeframe within which you must exercise the conversion option. Once exercised, the group life cover will become a normal life insurance policy on which you pay the premiums. The benefit of a conversion option is that you can usually acquire the cover without having to undergo any medical tests.

As mentioned above, any deferred compensation policy paid out or ceded to you at retrenchment will be taxed as normal income. If, however, you cede the deferred compensation policy to an approved retirement fund, the transfer will be tax free.

Retirement lump sum table

Taxable income from lump-sum benefits	Rate of tax
Not exceeding R500 000	0%
Exceeding R500 001 but not exceeding R700 000	18% of taxable income exceeding R500 000
Exceeding R700 001 but not exceeding R1 050 000	R36 000 plus 27% of taxable income exceeding R700 000
Exceeding R1 050 000	R130 500 plus 36% of taxable income exceeding R1 050 000

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