

Redundancy

June 2020

WHAT ARE THE TAX CONSEQUENCES OF YOUR REDUNDANCY PACKAGE?

Individuals often assume that the first £30,000 of any payment received by themselves on redundancy is tax free. This is not the case, payments can be exempt, partly taxable or fully taxable. This factsheet outlines the tax treatment for payments commonly made when an employee is made redundant. Please ask if you require further information specific to your circumstances.

HOW MUCH IS EXEMPT?

There is a £30,000 exemption available for redundancy payments. However, this only applies if the payment is not otherwise chargeable to income tax.

IS ANYTHING ELSE EXEMPT?

The following payments are completely exempt from income tax and are not included in the £30,000 exemption noted above:

- Payments made on the death of the employee
- Payments made on account of injury / disability of the employee.
- Contributions by the employer to a registered pension scheme
- Payments relating to employments with a very substantial element of foreign service (see overleaf)
- Legal costs where they are paid directly to the employee's solicitor on account of any legal action on their loss of employment
- Counselling provided on account of their redundancy
- Compensation attributable to discrimination, which would be unrelated to the dismissal

PARTLY TAXABLE PAYMENTS:

COMPENSATION

A payment made to compensate an employee for the employer's breach of contract (ex-gratia payment) is not made in return for services and is not taxable under general principles. The payments may be:

- Damages for breach of contract
- Damages for wrongful dismissal
- Wages paid in lieu of notice where employee is instantly dismissed and contract provides for a relevant notice period
- Redundancy payments

Payments not made to compensate for loss of employment are taxable in full. Otherwise, payments are partially exempt and the first £30,000 is free of income tax.

Statutory redundancy payments, up to a weekly maximum of £400 are included within the £30,000 exemption.

PAYMENTS IN LIEU OF NOTICE (PILONS)

From 6 April 2018, PILONS are taxable as earnings regardless of whether they are contractual or not. Prior to this date, certain non-contractual PILONS were not subject to income tax up to the £30,000 exemption.

A calculation of "post-employment notice pay" (PENP) is now required to determine the PILON element of a termination payment. Broadly, this is calculated as the employee's basic pay excluding overtime and bonuses in reference to the unworked notice period.

The PENP is then compared to the termination payment.

- If the PENP is greater or equal to the termination payment the full amount is subject to income tax and national insurance contributions.
- If the PENP is less than the termination payment, the excess amount is treated as qualifying for the £30,000 exemption.

TAXABLE PAYMENTS

A payment is taxable as employment income if it is made in return for services. If the following are due to an employee under their contract of employment, they would be taxable as employment income and subject to PAYE and NIC in the normal fashion:

- Wages owing
- Bonus payments
- Benefits (see overleaf)
- Holiday pay

PRECEDENT PAYMENTS

Where a payment is made and it is not covered by the employee's contract of employment, if there is a general expectation that the sum will be paid, the sum will be taxable as though it were.

IT'S ALL RELATIVE

It is not possible to avoid the tax consequences of a payment simply by making payment to an employee's spouse or another relative.

FOREIGN SERVICE RELIEF (FSR)

With effect from 6 April 2018, FSR has been withdrawn for UK resident employees (with the exception of seafarers). Prior to this date, relief for payments received on termination of an employment was given where there was an element of foreign service.

CAPITAL SUMS RECEIVABLE FOR RESTRICTIVE COVENANTS

An employee may, upon leaving their employment, agree to enter into a restrictive covenant in exchange for a capital sum. These sums are treated as employment income, with PAYE and NIC applied accordingly. The £30,000 exemption is not available to offset against such payments.

NATIONAL INSURANCE CONTRIBUTION (NIC) POSITION FOR TERMINATION PAYMENTS

If a payment qualifies for the £30,000 exemption, the whole payment is currently exempt from employers and employees NIC.

From April 2020, Class 1A employers NIC (currently 13.8%) will be payable on any element which exceeds the £30,000 exempt amount. This will need to be factored into the cost of any future termination payments.

The position for employees will remain unchanged and will continue to be exempt from NIC on the whole payment providing the termination payment qualifies for the £30,000 exemption.

WHEN ARE TERMINATION PAYMENTS TAXED?

Any taxable termination payments are taxed as employment income in the tax year in which the payment is received.

Tax payable on the cash element of a termination payment is due via the PAYE system.

BENEFITS IN KIND

It is quite common to provide employees with ongoing benefits, such as a company car or a beneficial loan. These are taxable in the year in which the benefit is received.

IS MY REDUNDANCY PAY TAXABLE?

It can often be difficult to determine whether a payment made on termination of employment is earnings or compensation. If you would like some further advice regarding your circumstances, please do not hesitate to contact us for further advice.

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