HM Revenue & Customs Consultation

Simplification of the Tax and National Insurance Treatment of Termination Payments

Response from Thompsons Solicitors

October 2015

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SOLICITORS
STANDING UP FOR YOU

Introduction

Thompsons Solicitors is a law firm which acts on behalf of most of the trade unions in the UK from offices in all four UK jurisdictions. At any one time we will, as a firm, be handling over 10,000 employment cases ranging from individual unfair dismissal matters and discrimination claims to multi party actions on, say, equal pay. Last year we provided advice on nearly 7,000 settlement agreements. We also offer a personal injury service to trade union members and run over 35,000 personal injury cases per year. We have a team of lawyers who act for members accused of work related crime.

Thompsons is responding to this consultation as a law firm practicing in employment law.

Q1 Do you agree that the distinction between contractual and non-contractual termination payments should be removed? Please provide reasons for your answer.

We share the government's belief that "… there is a principled case for providing support in the form of tax and NICs relief when someone loses their job." We welcome too the policy intention "…**to support those who lose their job through no fault of their own** [emphasis added]."

We therefore agree that this distinction should be removed as these principles are inconsistent with the current position of tax liability being dependent upon contractual serendipity. It will also help remove some uncertainty. Settlement agreements usually require the employee to give a tax indemnity to the employer which is often unsettling for employees, even where both parties are confident that it will be otiose. If removing that distinction can remove that sort of uncertainty then we welcome it.

Q2 Do you agree that removing the different tax and NICs treatment of different types of PILONs will help remove complexity for termination payments? Please provide reasons.

Yes. Removing the distinction is consistent with the principles previously identified.

The trade union members for whom we act generally do not receive termination bonuses, or golden parachutes. Their termination payments generally amount to little more than pay in lieu of notice, a final salary reckoning and a redundancy payment which sometimes exceeds the statutory entitlement although generally falls within the existing £30,000 limits. The PILON position is therefore of key importance to our clients.

Q3 Do you think that the income tax and NICs treatment of termination payments should be aligned? Please provide reasons.

Yes for the reasons outlined above.

Q4 Do you think that aligning the income tax and NICs treatment of termination payments will make termination payments easier to administer and easier to understand? Please provide reasons for your answer.

Where there is a genuine simplification we would expect consequential improvements in both understanding and administration. We are concerned however that the uneven application of the principles previously identified will undermine this. We explain this more fully below.

Q5 The government would like to explore what level the threshold for the termination payment tax and NICs exemption should be set and would welcome views. Please provide reasons for your answer.

We are not accountants or tax advisors but we believe that it should go up substantially on two grounds:

1. The consultation says that the existing system was unfair to lower earners because they could not structure their tax affairs as beneficially as their richer counterparts. The suggested solution is therefore to reduce the lower earners' exemption by 80% to pay for including non-contractual schemes that many of the lower wage earners won't actually have. The OTS report notes that "average pay-offs in the UK are now near £14,000" and yet the exemption level proposed is a drop from £30,000 to £6,000. We cannot see how that is (in the consultation's words) 'targeting relief at those most in need'.

2. The current £30,000 level was set in 1988 and had it followed the RPI it would now be £75,442.98.

Q6 Do you agree that a relief based on length of service and those who are being made redundant would be easier for employers to administer? Please provide your reasons.

We do, but we do not see it as desirable.

If "… the policy intention is to support those who lose their job through no fault of their own" then it makes no sense to link that to length of service. Someone may be dismissed through no fault of their own at any time and for reasons unrelated to redundancy. One particularly common example is dismissal for ill-health which is serious enough to be incapacitating, but not so as to be classed as a disability under the Equality Act 2010.

The proposed link between length of service and redundancy pay is particularly undesirable. An employer would have a positive incentive to dismiss before two years continuous employment in order to avoid potential liability for unfair dismissal and statutory redundancy payments.

We also note that many cases brought to the Employment Tribunal involve the question of whether the employee has sufficient continuous employment or not. This can be particularly complex in TUPE situations, or where an employer has structured the business to evade employment obligations through sham status practices[1]. It cannot be desirable for an employee, who has no say in these arrangements, to have their tax position determined by such arrangements.

Many Employment Tribunal claims involve dispute over whether the employee was made redundant or not. It is not necessarily a straightforward issue in law, and its simplicity is perhaps greater in the abstract than the application.

Sometimes an employer will call a dismissal 'a redundancy' in order to hide the true motivation. This may range from a relatively benign deceit to save the employee's feelings for not fitting in, through to concealment of serious unlawful behaviour such as targeting whistleblowers or trade union representatives. An employee who wishes to challenge that dismissal in an Employment Tribunal may be deterred from doing so if they face a tax liability for successfully challenging the redundancy label attached to their termination. This would be a barrier to justice, and would encourage poor employer practices. It is worth always bearing in mind in the context of the employment relationship that one party constructs, runs and operates the entire dismissal process.

We believe that these are strong public policy reasons against this approach.

Q7 Do you think that structuring the relief based on length of service and redundancy will be easier for employees to understand? Please provide reasons.

No, and certainly not if the principle used to justify it is 'supporting those who lose their job through no fault of their own'. It makes no sense and we repeat our earlier concerns.

Understanding is only part of the equation necessary for a workable system. It needs to be readily applicable in the majority of cases without the need for arbitration by a specialist tribunal or tax authority, and must operate based on knowledge and information readily ascertainable to all concerned.

1 See for instance the sham self-employment arrangements in Autoclenz Ltd v Belcher [2011] IRLR 820 Supreme Court

Neither a length of service requirement, nor a link to redundancy makes any sense when judged against this principle. Even taking into account the exemptions which the consultation proposes, such an approach would have a negative impact on the following common 'no fault dismissal' situations:

- Any dismissal before two years continuous employment is acquired;
- Any dismissal that is said to be due to employee fault, but either is not at all (e.g. targeting whistleblowers on fabricated grounds[2]) or is but only to a degree that is inadequate to amount to a fair dismissal under the law;
- Any dismissal for ill-health falling short of disability;
- Any dismissal upon the ending of a fixed-term contract;
- Any dismissal that would be held to be unfair by an Employment Tribunal but which did not require any continuous employment.[3]

We note that the proposals exclude those on fixed-term contracts because they "are able to prepare and were aware of the terms they signed up to" [4.25]. This is hard to understand from a practical point of view. A fixed-term contract may be limited by time (e.g. a three month contract) or by an untimed event ('until that house is built'). It is common, especially in the Third Sector, for fixed-term contracts to be issued because they rely on the periodic renewal of third party funding. These arrangements can extend to years. Similarly, in the teaching profession, many are employed on a term-to-term basis which extends for years.

There are many fixed-term jobs which are so longstanding as to be effectively permanent in all but name. It is therefore glib to exclude them on the basis suggested and surprising from a government led by a party that champions self-employment and employment flexibility.

We also think that employees would have trouble understanding the assertion that "Linking the exemption to those who have been made redundant would target the relief at those who are most in need" [4.21]. The cost of living is no higher in redundancy dismissals than in capability dismissals, nor is it higher where you used to be employed for two years or more. It is though more likely that a redundant individual will have a redundancy payment as well as their pay in lieu of notice and so actually be in slightly reduced immediate need.

2 "Half of the whistleblowers who contacted us were dismissed or resigned after raising their concern. Eight out of ten whistleblowers suffered some form of reprisal", The UK Whistleblowing Report 2014 (2nd ed.), Public Concern at Work.

3 There are many of these 'Day #1' unfair dismissal categories such as dismissals relating to: jury service; health and safety; medical suspension; refusing to work on a Sunday; occupational pension trustee status and requesting flexible working to name but a few.

Q11 Do you think that the exemption for injury or disability should be maintained? Please provide reasons for your answer.

The discrimination award exemption is welcome, but it seems to require an Employment Tribunal judgment thereby imposing a disadvantageous position where immediate voluntary reparation is made. Significant access to justice and fees issues arise here, and it runs counter to the government's emphasis on resolving disputes without recourse to litigation.

If the discrimination exemption is limited to employees it will exclude all the non-employees who have discrimination rights, and will make them a disadvantaged group. This group includes, for example, job applicants who are unsuccessful due to discrimination, ex-employees who receive discriminatory references, or members of trade organisations.

We think that to be consistent with the stated principles 'injury' should include all medical conditions, however they arise.

The personal injury/disability exemption seems to exclude those sick enough to be dismissed for it, but not enough to be disabled, as well as those whose injury didn't arise through personal injury but, through no fault of their own, will nevertheless be suffering hardships and prejudice on the labour market.

Q12 Do you agree that by removing the requirement to differentiate between the different elements of payments made in connection with injury or disability will provide simplification? Please provide reasons for your answer.

No. We are not convinced that the current position is so complex as to require simplification. We also infer that the exemptions would apply only where the redundancy and continuous employment elements were also met. This is not appropriate.

Q13 Do you think that there should be a cap on the amount of tax and NICs relief that is provided where the payment is connected with injury or disability? If so please provide reasons and suggested amounts.

At present the s.401 exemption applies to any payment made on termination which is paid wholly on account of an injury or disability. There is no maximum limit to payments made pursuant to s.401 as such payments do not count towards the £30,000 threshold under s.403(1) ITEPA 2003.

The present formulation of the injury and disability exemption should be retained and should not be linked to length of service or subject to any cap. Individuals whose employment is terminated by reason of injury or disability find getting new work disproportionately harder and it is appropriate that they are given a greater financial buffer during unemployment. This also should enable them to be less reliant on state benefits.

Q15 Do you think any of the other exemptions should be maintained? If so which ones? Please provide reasons for your answer.

Whilst we do not propose to answer this in detail we would say that the payments to meet legal costs should be retained (s.413A ITEPA 2003). Many employers who wish to make an ex-gratia termination payment to an employee, will require the employee to sign a Settlement Agreement confirming that the payment is in full and final settlement of any claims. In order that Settlement Agreements can become legally binding, statute requires that the employee takes independent legal advice on the document. In our experience it is usual for an employer to make a contribution to the employee's legal costs. Removing the exemption may have the effect of increasing an employee's liability to tax on a termination payment. This would make it far more difficult for employers and employees to reach an amicable agreement on termination of employment and would, again, undermine the government's desire to resolve disputes without litigation.

Q17 Do you think that there should be a financial cap, above which income tax (and possibly NICs) should be payable in cases of unfair or wrongful dismissal? Please provide reasons for your answer.

No, there should be no financial cap. If a payment is to be compensatory in nature it is illogical that only part of the payment should be exempt from the imposition of tax and NICs. Compensation in these circumstances is intended to place the individual in the position that they would have been in had they not been wronged. We disagree with any approach that says relief will be restricted to circumstances where a "termination payment has been made in connection with a redundancy as defined in section 139 of the Employment Rights Act 1996".

It also remains unclear to us how the proposals would work where arrangements are agreed between the parties. To know whether a dismissal is wrongful or unfair requires an adjudication by an Employment Tribunal. However, an agreed settlement means that there will be no adjudication and we cannot conceive why employers would concede that voluntarily.

Q18 Do you think that that should be any differentiation in terms of a financial cap where payments have been settled by a tribunal or an arrangement between an employee and employer? Please provide reasons for your answer.

No. This seems to be a complication, not a simplification, and undermines the government's policy on resolving disputes without litigation.

Q19 Do you think that there should be a financial cap, above which income tax (and possibly NICs) should be payable in cases of discrimination? Please provide reasons for your answer.

No. Thompsons' position is that as compensation is to compensate an individual for their loss they should receive it all. Otherwise they lose out twice. An arbitrary cap would therefore act as a barrier to justice.

Q20 Do you think that that should be any differentiation in terms of a financial cap where payments have been settled by a tribunal or an arrangement between an employee and employer? Please provide reasons for your answer.

No. This seems to be a complication, not a simplification, and undermines the government's policy on resolving disputes without litigation.

Claw Back

There is no question about this, but we feel an observation is required. Paragraph 4.26 says:

"The payments would also become taxable and liable to NICs if the employee is re-engaged to do a similar job for the same company or associated company (such as another company within the same group) within a 12 month period."

We note the resonance with payments made in the public sector (Part 11 Small Business, Enterprise and Employment Act 2015) - and the fact that this was a measure to prevent abuse - but question how appropriate this is.

By law an employee is redundant based upon the facts existing at the both the time when the dismissal occurred and at the time when prior notice was given.[4] It is perfectly possible, and not uncommon, for redundancies to be genuinely made, and then former staff re-employed when business picks up again. The law requires employees to mitigate their losses by finding new employment, and it is common-sense to seek to apply ones skills and acumen in a familiar environment. We see no good reason why staff in these situations should be penalised for doing either of these things.

According to the government, the statutory redundancy pay scheme, which was originally introduced in 1965, exists to ensure that employees who are made redundant receive at least a statutory minimum severance payment that recognises the degree of their past commitment to the employer's business, and to promote labour market flexibility by easing the process of job transition (DTI Partial Regulatory Impact Assessment, Statutory Redundancy Pay, July 2005). The claw-back disregards this and will welcome some new-starters with a tax demand. We therefore consider that it is misguided.

4 Parkinson v March Consulting Ltd [1998] ICR 276, Court of Appeal

Impact Assessment

We note that there is no impact assessment. This is to be regretted.

This consultation expressly arises from the report by the Office of Tax Simplification and we note what they said of these measures "Reforms along the lines we have suggested will help some who lose their job yet find their termination payment is fully taxable; others may currently benefit from a tax-free amount yet do not qualify for statutory redundancy. If ministers decide to pursue this route, which we believe will be simpler, more data on potential winners and losers will be needed." The government's own guidance requires one unless it is a Fast Track case. [5] The quality of responses would have been improved had there been an impact assessment.

Details of respondent

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