

Simplification of the Tax and National Insurance Treatment of Termination Payments
HM Revenue & Customs (HMRC) and HM Treasury (HMT) consultation document
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

- 1.1 We welcome the opportunity to respond to the HMRC and HMT consultation document on draft legislation to simplify the income tax and National Insurance contributions (NIC) treatment of termination payments.
- 1.2 This consultation follows the consultation in 2015,¹ which aimed to continue the work of HMRC to implement proposals put forward in a report by the Office of Tax Simplification (OTS), following their review of employee benefits and expenses.² The legislation on tax and NIC on termination payments is intended to provide support to those who lose their job; provide certainty for employees and employers; be simple; take into consideration the complexity that the OTS highlighted in their report; and be fair and not open to abuse or manipulation. Unfortunately, we thought that the proposals in the original consultation

¹ *Simplification of the tax and National Insurance treatment of termination payments* – HM Revenue & Customs and HM Treasury (July 2015): <https://www.gov.uk/government/consultations/simplification-of-the-tax-and-national-insurance-treatment-of-termination-payments>. The LITRG response is available on the LITRG website: <http://www.litrg.org.uk/latest-news/submissions/151014-simplification-tax-and-national-insurance-treatment-termination>.

² *Review of employee benefits and expenses: final report* – Office of Tax Simplification (July 2014): <https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-final-report>

were unlikely to deliver genuine simplification for employers and employees; we thought the proposals would raise more revenue for the Government and were concerned that the changes would almost certainly disadvantage low income employees.

- 1.3 We reiterate in brief the two observations we made at the outset of our previous submission.³ Firstly, the income tax and NIC treatment of termination payments should fully take account of employment law. When employers are considering termination payments and employees are trying to understand them, differences between employment law and tax law only create complexity. Secondly, alignment of the income tax and NIC treatment of termination payments will eliminate some burdens for employers (although it is likely to increase the Class 1 NIC burden), but unless and until there is complete alignment or integration of income tax and NIC, discrepancies, and therefore complexity, will remain. Any changes to the termination payments regime ought not to result in a less favourable outcome for low income individuals, particularly as the proposals are being brought forward under the banner of fairness and simplicity.
- 1.4 We welcome the fact that the revised proposals remove the distinction in treatment between the different types of PILONs, as this will assist in reducing complexity. Since the general distinction between contractual and non-contractual termination payments will remain (on the basis that this is fairer), we note that employers will still need to consider the nature of constituent parts of the termination payments and in some cases will need to perform fairly complex calculations in order to determine the amount to be treated as earnings and the amount eligible for the £30,000 exemption.
- 1.5 We welcome the retention of the £30,000 threshold for the exemption for eligible termination payments. This should ensure continued support for those individuals losing their jobs.
- 1.6 We welcome the fact that employees, already in a vulnerable position due to losing their job, will continue not to have an NIC liability on their termination payment.
- 1.7 We recommend that HMRC consider the impact that these changes will have on tax credits and universal credit. In addition, HMRC and DWP must ensure that any changes that affect tax credits and universal credit are communicated to claimants, to ensure that they treat them correctly when telling HMRC and the DWP about their income and capital.
- 1.8 It will be necessary to provide guidance and educational resources for employers, particularly for the smaller employers that have fewer resources.

³ Paragraphs 1.3 and 1.4: <http://www.litr.org.uk/latest-news/submissions/151014-simplification-tax-and-national-insurance-treatment-termination>.

2 About Us

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Introduction

- 3.1 We agree with the stated aims of the reform of termination payments, as set out at paragraph 3.5 of the consultation document. Simplicity, certainty, ease of administration and fairness are key principles for taxation generally. We also acknowledge that the policy must be affordable for the Exchequer.
- 3.2 Treating all payments in lieu of notice (PILONs) as earnings and subject to tax and NIC brings simplicity and certainty, both for employers and employees. The removal of the distinction between contractual and non-contractual PILONs will also be fairer, as the tax and NICs treatment will not be dependent on the employment contract.
- 3.3 Subjecting all other post-employment payments, which would be treated as general earnings if the employee worked their notice period, to tax and NIC also helps meet the aims of the reform, by creating consistent and fair treatment of post-employment payments.
- 3.4 The continuation of the £30,000 exemption for payments relating to the termination appears sensible, as this is a figure understood by many. We welcome the decision not to reduce this exemption, which ensures that individuals already placed in a vulnerable position due to the loss of their employment continue to be supported. There is some additional complexity though, as there will continue to be a discrepancy between the tax and NIC treatment on amounts that exceed £30,000, and indeed an additional layer of complexity

with the change to different approaches for employer's and employee NIC.⁴ We also continue to have a slight concern that imposing an employer's NIC on an employer making redundancies might mean a lower termination payment for the employee, although this will be mitigated (in the majority of low-income cases) by the fact that the exemption is being maintained at £30,000. We note that at least the employee will not face a NIC liability.

- 3.5 We welcome the decision to retain many of the existing exemptions, particularly those in respect of payments due to the death, disability or injury of the employee and those made to HM Armed Forces. We think that the proposed amendment in respect of the exemption for injury is sensible, provided that steps are taken to ensure that HMRC are properly able to identify cases where there is injury or disability of a psychological nature.⁵

4 Q1. Is it appropriate to use a period of 12 weeks to calculate the cash and benefits element of the 'post-employment notice income'? Are there any circumstances where this could lead to unfair outcomes?

- 4.1 We think some research and analysis should be undertaken to establish how a period of 12 weeks would affect the following groups: individuals in seasonal employments and individuals on maternity leave or sick leave.⁶

5 Q2. We have given bonus a wide meaning in this legislation. Is this appropriate?

- 5.1 Draft section 402D defines "expected bonus income". The definitions refer to benefits or payments that employees "could reasonably be expected to receive". We think that clear guidance will be required to ensure consistency of treatment as to what is deemed "reasonable". In particular, consideration may need to be given as to whether or not a bonus is contractual and the contingencies on which it depends. The definitions continue with the definition, "were the employee to continue in the employment long enough to receive it." While for anti-avoidance reasons it may be preferable not to include a timescale in the legislation, it would seem unreasonable to include a bonus that would only be payable if the

⁴ For example, a termination payment of £40,000 will be treated as follows: no tax / employer's NIC / employee NIC on the first £30,000; tax and employer's NIC, but no employee NIC, on the remaining £10,000.

⁵ For example, we hope that HMRC will recognise a psychiatric report from the Ministry of Defence, say, or one submitted as evidence in a successful personal injury claim.

⁶ For example, if an individual works in a seaside café, they would probably earn more in the period June to September. If the individual was made redundant in March or October, their previous 12 weeks' earnings might not reflect 'annual' earnings.

employee were to remain in the employment a significant length of time beyond the actual end of their employment, say six months or a year.

6 Q3. We have used a wide interpretation of ‘arrangements’ in the anti-avoidance provision at s402D(9). Is this sufficient?

Q4. We are considering what other anti-avoidance provisions may be needed in the legislation. Are there other aspects of the policy that might require anti-avoidance safeguards and how should these be targeted?

6.1 We have no comments.

7 Q5. To comply with this draft legislation, are there any additional pieces of information that employers and payroll managers would need to identify beyond what they already have available?

7.1 We have no comments, other than to request confirmation from HMRC of what employer clearance facilities exist in relation to termination payments, since this can cause confusion for smaller employers.⁷

8 Q6. Are there other aspects of the termination payments legislation that the government should address while we have this opportunity?

8.1 We recommend that HMRC consider the impact that these changes will have on tax credits and universal credit. Currently, tax credits follow the income tax position in so far as only termination payments which are chargeable to tax are included as employment income in determining the value of a tax credits award. The changes in respect of PILONs and post-employment payments (meaning that they will always be treated as earnings and subject to income tax and NIC) may adversely impact the value of tax credits awards for low income workers losing their jobs – this is because some payments that would previously have been eligible for the £30,000 exemption will become taxable and therefore included as income in their tax credits assessments. We recommend that corresponding changes are accommodated in tax credits legislation to ensure the changes do not disadvantage claimants. For universal credit, termination payments are treated as capital and further support for low paid workers could be provided if there was a corresponding move to exclude non-taxable termination payments from the universal credit assessment altogether.

⁷ It is important that smaller employers understand whether or not there are clearance facilities and if so, what they cover and how to access them.

- 8.2 Perhaps most importantly, any changes that affect tax credits and universal credit will need to be communicated to claimants, to ensure that they treat them correctly when telling HMRC and the DWP about their income and capital.
- 8.3 In respect of post-P45 employment payments (for example holiday pay), we have come across examples whereby low-income employees lose out, because of the application of a weekly NIC earnings period (rather than a monthly period). This means they face an NIC liability or a higher NIC liability than they would have faced if their normal, monthly NIC earnings period had been applied. When an individual has previously been paid monthly, it seems somewhat unfair that a weekly NIC earnings period is applied to the post-P45 payment of holiday pay. We think the question of what length of earnings period for post-P45 payments is appropriate (weekly or monthly) is an area that could be looked into.

LITRG
04 October 2016