Deductions for employee liabilities: certain legal expenses etc.
Termination payments: treatment of certain legal expenses etc.
Termination payments etc.: amounts chargeable to tax on employment income
Consultation on draft clauses for Finance Bill 2017
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 We welcome the opportunity to comment on the draft clauses for Finance Bill 2017 in relation to deductions for employee liabilities (clause 7) and termination payments (clauses 8 and 9). LITRG previously responded to the consultation on the simplification of the tax and National Insurance contributions (NIC) treatment of termination payments in 2015[1] and submitted comments on the initial draft legislation in October 2016.[2]

1.2 This consultation response should be read in conjunction with our response to the consultation on the draft clauses for the National Insurance Contributions Bill 2017 in relation to termination awards.[3]

1.3 We welcome the extension of existing reliefs to employees (or former employees) for costs of legal advice and indemnity insurance funded by their employer in connection with

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[1] http://www.litrg.org.uk/latest-news/submissions/151014-simplification-tax-and-national-insurance-treatment-termination.

[2] http://www.litrg.org.uk/latest-news/submissions/161004-simplification-tax-and-national-insurance-treatment-termination.

[3] The LITRG response in relation to the National Insurance contributions Bill 2017 has been submitted to consultation.nic@hmrc.gsi.gov.uk.

proceedings relating to the employment where no allegation has been made or is expected to be made against the employee (clause 7).

1.4 We also welcome the extension of existing reliefs to individuals on termination of employment who may receive a benefit or payment in respect of legal advice or indemnity insurance which is funded by their employer (clause 8). The extension means that a deduction is allowed if the costs are met by the employer directly; without this extension a deduction is only available where the individual has first paid the costs.

1.5 The proposals on termination payments (clause 9) were originally brought forward under the banner of fairness and simplicity. We think therefore that the changes ought not to result in a less favourable outcome for low-income individuals.

1.6 We broadly welcome the approach adopted, in particular the retention of the £30,000 exemption for eligible termination payments and 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 Finally, we would strongly suggest that there should be consideration of the impact that these changes will have on tax credits and universal credit. In addition, it is essential that any changes that affect tax credits and universal credit are communicated to claimants, to ensure that they treat them correctly when telling HM Revenue & Customs (HMRC) and the Department for Work and Pensions (DWP) about their income and capital.

2 About Us

2.1 The 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 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 General comments

3.1 The Office of Tax Simplification (OTS) recommended simplifying the tax treatment of termination payments in its third report on employee benefits and expenses.[4] The OTS suggested that the easiest route to simplification was for income tax relief to be available only where the employee qualifies for a statutory redundancy payment. The Government consulted on the simplification of termination payments in July 2015 and then on draft legislation in August 2016.

3.2 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.

3.3 Given that the threshold of £30,000 has been steady at that level since 1988, we would however recommend that provision is included to regularly review the level, in order to assess whether it should be uprated.

3.4 We welcome the changes in the draft legislation from that brought forward in August 2016, following consultation, such that the 'post-employment notice income' subject to tax and NIC is calculated as the amount of basic pay the employee would have received if they had worked their notice period.[5] This is a good example of listening to concerns raised during the consultation process.

3.5 The legislation also ensures that all payments in lieu of notice (PILONs) (whether contractual or non-contractual) are treated the same, as taxable earnings subject to income tax and NIC. This means that the position is fairer, as the tax and NIC consequences no longer depend on the way in which an employment contract is drafted.

3.6 We welcome the fact that the employee will not face a NIC liability on eligible termination payments, even to the extent they exceed £30,000. Undoubtedly this means there is some continuing complexity, as for employees there will continue to be a discrepancy between the tax and NIC treatment on amounts that exceed £30,000. For employers, there will indeed be an additional layer of complexity with the different approaches for employer's and employee NIC. This could result in errors, if there is confusion as to whether a termination payment should be subject to employer's NIC, employee NIC, both or neither.

3.7 We also continue to have a slight concern that imposing 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

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[4] https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-final-report.

[5] The proposal in August 2016 had been that the 'post-employment notice income' that the employer would need to calculate was to include expected bonus income.

being maintained at £30,000. Furthermore, termination settlements for lower earners could be depressed as a result of the employer having to pay employer's NIC on settlements for higher earners.

3.8 We recommend that there is consideration of 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.

3.9 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.

4 Comments on draft legislation

4.1 ***Clause 7 Deductions for employee liabilities: certain legal expenses etc.***

4.1.1 Draft clause 7 (4) (a) should read "**after** paragraph B", rather than "in paragraph B".

4.2 ***Clause 8 Termination payments: treatment of certain legal expenses etc.***

4.2.1 No comments.

4.3 ***Clause 9 Termination payments etc.: amounts chargeable to tax on employment income***

4.3.1 No comments.

LITRG
27 January 2017