# Simplification of the tax and National Insurance treatment of termination payments

Employment Tax | Personal tax

01 January 2016

LITRG/CIOT respond to the joint HMRC/HMT consultation

LITRG and CIOT have responded to a joint HMRC/HMT consultation on the simplification of the income tax and National Insurance Contributions (NICs) treatment of termination payments. The proposal is to remove the distinction between the treatment of contractual and non-contractual termination payments so that all of those made in connection with termination of an employment will be 'earnings' subject to income tax and employer and employee NICs. An exemption from tax and NICs is provided in some circumstances.

LITRG raised concerns that the proposals are unlikely to deliver genuine simplification for employers and employees; in particular, LITRG is worried that the changes will disadvantage low-income employees.

LITRG observed that the tax treatment of termination payments should take account of employment law. In that regard, LITRG was disappointed that the consultation did not recognise the preference of the OTS for tax relief to be available only when the employee qualifies for statutory redundancy (and equivalent situations for those unable to qualify for redundancy). This would make it easier to understand when relief is available and would result in a common approach between employment and tax law.

In addition, LITRG pointed out that alignment of the income tax and NIC treatment of termination payments would eliminate some burdens for employers (although it is likely to increase the Class 1 NIC burden for employers and employees). But unless there is complete alignment or integration of income tax and NIC discrepancies and

complexity will remain.

LITRG asked that any changes to the termination payments regime should not result in a less favourable outcome for low-income individuals, particularly since the proposals are being brought forward under the banner of fairness and simplicity.

LITRG noted that, to achieve true simplification, radical changes are needed, including the removal of many of the exemptions. But LITRG feels there are justifications for retaining several of these, including the exemption for termination of employment due to disability or injury. Therefore, LITRG believes there should be greater consideration of policy objectives and the likely winners and losers before decisions are made on how to proceed.

LITRG also noted the importance of ensuring that tax credits and universal credit claimants are not disadvantaged by any changes. Currently, tax credits follow the income tax position in so far as only termination payments that are chargeable to tax are included as employment income in determining the value of a credits award. A move away from that general position may diminish the value of tax credits awards should termination payments become taxable and are included as income in assessments.

The CIOT felt the consultation would present an opportunity for simplification that should not be missed. Whole chapters have been written on the taxation of termination payments and there is now a chance to make a difference.

The CIOT noted that the reason the exempt amount had been introduced was to alleviate the hardship caused on the loss of employment, primarily by blue collar workers. Nothing has changed in this regard. The loss of employment will almost always cause hardship for the employees and families affected.

The consultation considers linking an exemption for termination payments to redundancies falling within Employment Rights Act 1996 s 139, although the proposals go wider than this in terms of preserving the exemption in cases of unfair or wrongful dismissal as well. If enacted, the question is whether employers will be clear on when the exempt amount applies and when it does not. Views differ on this. Some consider that, because the employment law position already has to be considered on a termination, there should not be an issue. Others are less convinced and feel that employers may be confused, particularly given that it is not just whether a termination is a redundancy but also whether unfair or wrongful dismissal

is or may be involved. Consequently, we made no firm recommendation on this point.

The CIOT agreed that removing the distinction between earnings and compensation payments would mean one less step when determining the tax analysis. Some would say that the present issue of earnings versus compensation centres on arguments around non-contractual PILON (payment in lieu of notice) versus contractual PILON versus ‘auto-PILON’ and that, if this were clarified, it would ‘go away’. There is equally a view that the argument extends beyond this to ‘custom and practice’. The CIOT felt it would be a good thing to end this sterile debate in toto by treating earnings and compensation payments alike.

The CIOT also agrees that aligning the tax and NICs treatment of termination payments would undoubtedly be simpler for employers, but this would come at a cost to businesses and employees. The exemption should therefore be set to take account of the increase in NIC, which the Exchequer would receive.

The LITRG submission is available here.