Response from ICAS
Simplification of the tax and National Insurance treatment of termination payments: consultation on draft legislation

4 October 2016

About ICAS

1. The following submission has been prepared by the ICAS Tax Committee. This Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to contribute to 'Simplification of the tax and National Insurance treatment of termination payments: consultation on draft legislation', issued by HMT and HMRC on 10 August 2016.

3. It is disappointing that an opportunity for genuine simplification of the entire termination payments regime is being missed. Whilst some aspects of the proposals do represent simplification other aspects will make the treatment of termination payments more complicated, producing new uncertainties for employers and employees.

4. We believe it would be preferable to revisit the Office of Tax Simplification (OTS) suggestions for real simplification rather than replacing one complex regime with another. This might require a lower exemption than the current £30,000, to protect the exchequer. However, as discussed below, the current proposals will often result in increased taxable amounts but without the simplification benefits of the broader OTS proposals.

Simplification and certainty

5. The policy objectives set out in paragraph 2 of the consultation include: **"***the rules should provide certainty for employees and employers; the rules should be simple; the complexity that the Office of Tax Simplification highlighted in their report should be taken into consideration*".

6. The OTS identified the distinction between contractual and non-contractual termination payments and the different treatment of different types of payments in lieu of notice (PILONs) as key complexities under the current rules. ICAS supported the removal of these distinctions but only as part of the introduction of a new (simpler) overall regime for termination payments. The proposals do not include such a new regime.

7. The distinction between different types of PILONs has been removed but the proposals relating to post-employment notice income and expected bonus income are complex. They are unlikely to be easily understood by employees or employers and will create new uncertainties and administrative burdens, as well as higher tax and NIC charges for some employees. There will also be considerable scope for disputes about the calculation of the taxable amounts (especially of bonus income) between employers, employees and HMRC.

8. The alignment of the NIC treatment (for employers) with the tax treatment is a simplification but may have an impact on the amounts employees receive, as discussed below.

9. The current foreign service exemption gives rise to considerable complexity so its removal is a simplification. The OTS suggested that the fairness of removing the exemption would also need to be explored; as noted in our response to the original consultation we do not have any evidence which would allow us to comment on this aspect.

Support for those who lose their job

10. Another policy objective is that the *"the tax system should continue to provide support to those who lose their job"*. The consultation notes that individuals will continue to be supported through the retention of the exemption from income tax for the first £30,000 of a termination payment. Also the exemption from employee NICs on termination payments remains unchanged "to minimise the impact on individuals". However, these statements ignore the effect of the changes made to the scope of the exemption for termination payments.

11. The proposed draft legislation distinguishes between amounts which can continue to benefit from the £30,000 exemption (including statutory redundancy payments and compensation for unfair dismissal) and amounts which cannot. All post-employment payments which would have been treated as general earnings if the employee had worked their notice period will be subject to tax and NICs (employee and employer) and will no longer be eligible for the exemption. This is likely to result in a tax (and NIC) charge for some employees receiving total payments below £30,000 where, under the old rules, the whole payment would have fallen within the exemption for termination payments.

12. The alignment of the NIC treatment (for employers) with the tax treatment is a simplification, as noted above. However, the addition of employers' NIC to payments above £30,000 may cause problems for businesses with financial difficulties. It may also lead to a reduction in some payments because employers may choose to adjust the amounts paid to take account of employers' NIC. If the proposals also included significant simplification of the overall regime, the impact of the additional NIC might have been mitigated, as there would have been a reduction in administrative and other costs. Unfortunately, this is not the case.

13. The changes proposed will increase the tax/NIC yield for the Exchequer. This will inevitably mean smaller payments for employees. The likely impact of employers' NICs on termination payments above £30,000 (discussed above) may not be regarded as a major issue by government – as the average termination payment is around £14,000 (paragraph 12 of the consultation). However, the post-employment payment rules affect a wider range of recipients.

14. The retention of the exemptions listed in paragraph 27 is welcome. Payments relating to injury or disability are important for those who may find it particularly difficult to find another employment although ICAS would have liked to see the problems with this exemption that were raised by the OTS addressed. The exemption for legal costs is also important because of the need for employees to have independent legal advice.

15. No mention is made of the exemption for Outplacement Counselling in s310 ITEPA 2003. As noted in our response to the original consultation we believe that this should be retained. Outplacement counselling can be of considerable assistance in helping employees to find alternative roles, particularly if they have been with an employer for a long time and have no recent experience in the jobs market. Removing the exemption would be likely to reduce the provision of counselling. We would welcome confirmation that there is no intention to remove this exemption.

Calculation of "post-employment notice income" and "expected bonus income"

16. The calculation of these amounts could be very complicated in some cases, leading to uncertainty for employers and employees. The idea of taxing what would have been received if the employee had worked their notice sounds superficially simple but as the proposed s402D illustrates this is not necessarily the case.

17. Proposed s402D (2) and (3) try to deal with employments with irregular levels of earnings through use of an average value for general earnings (excluding bonus payments) over 12 weeks to produce the 'post-employment notice income'. This could produce unfair results in certain circumstances. For example, work on a particular project requiring large amounts of overtime (overtime pay is apparently included in the calculations and might be paid at higher rates) in the 12 week period could mean that the figure is too high (particularly where basic pay over a much longer period was considerably lower). It is also unclear how other issues affecting pay (maternity and paternity leave and sickness, for example) would be dealt with.

18. The anti-avoidance provisions in s402D (8) and (9) would involve consideration of a period of three years rather than 12 weeks, which would impose a considerable administrative burden on employers. These would only be relevant where there were 'arrangements' (as defined in sub-paragraph 9) to reduce the amounts of earnings to be taken into account in the 12 week period. The definition of 'arrangements' is broad and there is clearly scope for disputes with HMRC about the existence (or otherwise) of arrangements, leading to uncertainty.

19. The calculation of 'expected bonus income' (also in proposed s402D) gives rise to numerous potential complications. The intention of s402D (5) appears to be to tax the bonus (including commission, incentives and other similar payments) which the employee could reasonably be expected to receive in relation to periods before the end of the employment, if the employee had continued to be employed long enough to receive it.

20. In a simple case where the employee had worked for most of the bonus or commission period and the amount was linked to objective criteria (amounts of revenue generated, for example) this might be reasonably easy to establish. However, in many cases where the employment is being terminated part way through the period it could be much harder to determine. If could also be difficult if part, or all, of the bonus depends on subjective performance measures (rather than being linked to a quantifiable amount). In these circumstances there is scope for considerable uncertainty, for example, where the employer's view is that the bonus would have been lower due to poor performance but HMRC take the view that it is being artificially reduced for tax reasons.

21. S402D (6) is similar to s402D (5) but relates to the bonus or commission which might have arisen during the notice period, if the employee had worked during that period. Issues similar to those noted above arise – but these are likely to be exacerbated where the employee does not in fact work for any part of the period. The employee and employer might reasonably take the view that no bonus would be due but is this likely to be accepted by HMRC?

22. The proposals for calculating post-employment notice income and expected bonus income are complex and likely to cause considerable uncertainty for employers and employees. As noted above there is obvious scope for disputes with HMRC, particularly around the calculation of expected bonus income. However, there may also be disputes between employers and employees, particularly where employers' NIC would definitely be due – but employees' NIC might not be (depending on whether the payment fell within s402D or not).