ICAS response to the reform of Termination Payments per Draft Finance Bill 2017 Part 1 Chapter 1 (9)

25 January 2017

About ICAS

The following submission has been prepared by the ICAS Tax Board. This Board, with its five technical 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. ICAS is also a public interest body.

General Comments

ICAS welcomes the opportunity to respond on the reform of termination payments per Draft Finance Bill 2017 Part 1 Chapter 1 (9).

ICAS reiterates its support for HMRC to create a regime that is easy for employers to administer and for employees to understand.

We reviewed the following documents together with our previous submissions of October 2015 and October 2016:

Draft provisions for Finance Bill 2017:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574680/newbook_book.pdf

The Explanatory Note at page 30 of this document:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574679/Explanatory_Notes_-_draft_provisions.pdf

Draft legislation that will form part of the National Insurance Contributions Bill and the Explanatory Note: https://www.gov.uk/government/publications/draft-legislation-termination-awards

The TIIN: https://www.gov.uk/government/publications/income-tax-and-national-insurance-contributions-treatment-of-termination-payments

Our comments are as follows:

We are pleased to note that some of the previous thinking on taxing bonus pay and benefits in kind has been discarded as this would have been totally impracticable for employers. Our response of October 2016 contained arguments for discarding these ideas and we are pleased to see that some of our arguments appear to have been taken on board.

There are, however, two issues which we would like to comment on in further detail.

1. We note that at section 404B of the draft legislation HMRC has left the door open for itself to amend the £30,000 figure if it so wishes. It is important for employers to be able to pay employees a tax free compensation payment on loss of office or employment and we would anticipate this figure may need to rise in future to adequately provide for a reasonable compensation figure on breaching the contract of employment without incurring any tax or NICs consequences.
2. We note that there appears to be an anomaly with section 402D subsections 3,5,6 & 7 where the employer is being asked to calculate the employee's basic pay for the whole year, or per subsection 5, if shorter than a year, then for that shorter period.

   Where an employee's pay drops during the year preceding the trigger date for a particular reason, for example, if they commence a period of maternity leave, they are demoted, they commence part-time working when previously working full-time or work less hours, or commence a period of sickness absence, this skews the results for the taxable element of the termination payment, resulting in a proportionately unfair tax liability on the recipient in comparison to a recipient who has not had a drop in salary or wages in the previous year.

It is not possible to calculate the taxable element at anything other than a disadvantageous position for the employee whose salary or wage goes down as one must take into account an average over the entire year or entire period of employment, if less than a year. Therefore, the shorter the period before termination that the salary goes down, or the higher the drop in salary, the bigger the differential between the averaged pay on termination using the new method under section 402D and the current pay using the old method as prescribed under ITEPA 2003, Part 6 Chapter 3.

We have set out an example, as follows:

A team of ten people within a department each receive a salary of £36,000 per annum. Due to financial pressures, the business agrees with each of the team that they will work reduced hours from January to March in an attempt to save jobs and improve cash flow. Their salaries are each reduced to £24,000 per annum for that period.

It then becomes clear at the end of February that the jobs cannot in fact be saved and proceedings are put in place to activate a redundancy round.

The team is monthly paid, and so they were previously receiving gross pay of £3,000 per month. The pay reduces to £2,000 for the period of three salary months January to March inclusive. The team is dismissed by reason of redundancy on the last day of March.

Each of the team members has a three month notice period but no payment in lieu of notice provisions are stated within the contracts of employment.

Therefore, the trigger date = 31 March (last day of employment). The end of the notice period is 30 June.

Basic Pay (BP) for the prior year is £33,000 (i.e. £36,000 - £3,000)

Using the formula prescribed at section 402D(1) - ((BP x D)/Y) – T:

((£33,000 x 3)/12) = £8,250. T = £0 therefore the result is wholly taxable and NIC'able as it falls outside of the £30,000 exemption.

However, the payment the employees would each have received, had they worked their notice in full, is £6,000 – thus there is a difference of £2,250 per worker. Additionally, under section 402D (1), had the employer paid a contractual PILON, this would also have been £6,000 and would have been taxed as earnings.

This could be seen as discriminatory in some cases, especially for women who are commencing maternity leave or for employees who are suffering from an illness or become disabled in some way.

Of course, if a person has a wages or salary rise in the year, this averages out in their favour as they are presented with a proportionately smaller tax bill. However this does not detract from the fact that some individuals will be put at a disadvantage on termination if their salary or wages fall at some point in the year preceding it.

We trust you can take this anomaly into consideration when considering the implications of the proposed legislation and allow tax relief to apply where an employee is disadvantaged in this way.