Kingston Smith
Helping clients succeed

# Redundancy and tax

*This question and answer appeared in the 'Ask an expert' section of 'The Manufacturer' website in May 2009.*

## Question:

In common with many businesses during this economic downturn we are having to contemplate making some employees redundant in order to save costs.

The packages we are considering include payment for contractual elements such as holiday pay, pay in lieu of notice and the usual contracted notice all of which we understand is subject to PAYE and NIC. In addition we are considering enhanced non-contracted redundancy pay in some cases approaching the £30,000 tax free limit for such payments. We have heard that HMRC are mounting an attack on such payments seeking to collect PAYE and possibly NIC from the employer.

As these payments are non contracted and not in substitution for any contracted element, can they really be attacked?

## Answer:

"When considering the £30,000 tax free allowance for termination payments it is important to realise that this does not automatically apply to any payment. A termination payment is likely to be made up of a number of different elements and each of these should be examined to determine the correct tax treatment. The first question to consider is whether the payment is made as part of the employment: if it is, it will be taxable. The payment of outstanding salary, bonuses or holiday pay will therefore be taxable, as will payments in respect of gardening leave.

Any amount for which provision is made in the employment contract, for example, payment in lieu of notice will be taxable. This concept is extended to any non-contractual amount which the employee would have a reasonable expectation of receiving. So, if the employer has a track record of making "ex gratia" termination payments to all employees that are made redundant, this could give rise to a reasonable expectation on the part of any employee being made redundant.

Payments made in respect of restrictive covenants are also subject to tax. If part of the payment can be attributed to payment to the individual for an undertaking that restricts his future conduct in any way, this will be taxable. Such conditions are often included in compromise agreements.

Only if the termination payment does not fit into any of the above categories will the £30,000 exemption apply, with the excess being treated as employment income. Statutory redundancy pay is exempt, but it uses up the first part of the exemption. For example, if the redundancy package includes £2,000 of statutory redundancy pay, only £28,000 the ex gratia payment could qualify for the exemption.

Any genuine ex-gratia redundancy payment will therefore be eligible for the exemption as will any genuine payment of "damages" by the employer for breaching the terms of the employment contract. However, HMRC will examine redundancy payments closely. The attack from HMRC will come where they believe that part of the payment relates to something other than a genuine ex gratia or damages payment. If they are able to argue that a payment in reality includes, say, a bonus that the employee could reasonably have expected, or restitution for a restrictive covenant, then they could reasonably tax these elements of the payment.

HMRC do provide an advance clearance service in respect of non-statutory redundancy schemes, however, applications for this service could take a considerable length of time to reach a conclusion."

## Contact

Maureen Penfold +44 (0)20 8848 5503

---