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Answer-to-Question-_1_

**** Draft Report - CM to Review ****

To: Freya Archibald and Jinny Barbayas, Rance Grey Ltd
From: Tem Finlanda and Cody McAmella, Tax Firm
Subject: Confidential - Rance Grey Ltd: Termination Queries
Date: 5 May 2021

Introduction

This report has been prepared for Rance Grey Ltd and Rance Grey Motor Media Ltd only and cannot be relied upon by any additional party. The report looks into the proposed termination of five Rance Grey Motor Media Ltd ("the Company") employees and the taxation consequences regarding the proposed termination packages.

Although individual taxation matters may be discussed throughout this report, the report has been prepared for the Company only and I recommend personal taxation advice is sought by the individuals. In addition, the report has been prepared to comment from a taxation perspective, and it is not intended to provide financial advice - and I recommend that a financial advisor is consulted in respect of the proposed transactions.

The report has been prepared based on UK tax legislation effective 5 May 2021.

Executive Summary

By considering the package for Option One and Option Two, I advise that the Company elects to provide Option One for the termination of the employees. This is because I have calculated that the individual will receive a net amount of £10,643 more under this package - and the costs to the employer are £6,444 less. Please see the Appendices for details of the calculations.

Not all elements of the termination package fall within the £30,000 exemption in S401 and each element should be considered separately - as all have different tax and NICs treatment.

It is noted that all of the individuals who's employment is being terminated are close to retirement age. This means the termination payment could be seen as that of a retirement payment, and in this instance the whole payment would be taxable. I advise the HMRC are approached to confirm that they agree that the payments are for genuine termination purposes and not by way or in anticipation of retirement.

As Bill is of ill health with a long-term disability, it may be that the termination payment can be made exempt from any tax and NICs - but confirmation of his long-term disability and the impact this would have on his role should be sought. Depending on the amounts saved within his pension fund, he may be able to obtain a lump sum exempt from taxation in the instance this relates to seriously ill health.

The continuous provision of the private medical benefit will need to be reported on an annual basis to HMRC so that income tax and Class 1A NICs can be accounted for.

The company car benefit for Oliver has been incorrectly reported on his 2020/21 Form P11D and this should be corrected by disclosing the error to HMRC as soon as possible - in order to minimise the potential penalties that they may levy. It should be correct prior to the end of Oliver's employment so that his tax code can be updated accordingly. If either individual purchase the car at a discount, the value of the car at a discount will form part of the taxable termination package.

Any termination payments made should be through the payroll and if a Form P45 has been issued the payroll team should apply a 0T tax code.

I advise that the period of termination notice should be three months prior to the individual's final workday in order to minimise the amounts classed as Post Employment Notice Pay - as the notice period would have been worked in full and subject to the standard tax and NICs deductions.

I recommend that a contribution to the individuals' pension scheme should be considered as an element of the termination package, because this can be made exempt from tax and NICs consequences for both the individual and the employer. Considering the ages of the employees that are being terminated, this may be a preferred option (although I recommend that financial advice is sought from a Company and individual perspective).

I suggest that legal advice is taken to ensure that the termination is compliant with employment law. As the oldest staff members are being terminated and a formal selection process has not been undertaken, there is the potential that the terminated employees may claim unfair dismissal - or that they have been discriminated against by Rance Grey Ltd as they have not been offered positions with this company but 10 less senior staff have been.

Reliefs may be carried forward from a group loss relief perspective from the Company to Rance Grey Ltd, but more information is required as to when the losses were incurred in order to determine any amounts that are available to be carried forward. In addition, the accrual for termination payments should be reviewed as only statutory redundancy will be allowable deduction in this instance for corporation tax purposes and therefore the accounts will need to be adjusted.

Main Body

Termination Package - Overview

S401

In order to determine the taxation position for both the departing employees and the Company, it is first required to consider the tax consequences of the proposed termination packages in general.

I note in the comments provided for the anticipated tax and NICs position for Option 1 that reference is made to the £30,000 - which is the exemption included within the rules of S401 ITEPA 2003.

S401 will apply when a payment is made upon termination of an employment and the payment made is not contractual - and there is no reasonable expectation that the payment will be made by the employer. Termination payments that meet this criteria can be paid exempt from tax and NICs up to the maximum of £30,000 - and any amounts in excess of the £30,000 is taxable on the individual and should be subject to Class 1A NICs payable by the Company. Any stautory redundancy payments that are made exempt from tax and NICs - which must be made under employment law regulations - will utilise the £30,000 exemption.

Post Employment Notice Pay

It is important to note that not all payments made in the instance of termination will fall within the exemption rules, and the terminating company will need to calculate whether any amounts paid to the individuals is regarded as Post Employment

Notice Pay (PENP). PENP must be calculated on every termination, and it equals the amount that the employee would have been paid had they have been employed to work throughout the entirety of their notice period. The PENP is treated as a normal salary payment and should be subject to PAYE and Class 1 NICs - and can never be paid exempt from tax or NICs.

Retirement

I understand that from the information provided all of the employees who are having their employment terminated are approaching retirement age. As such, I advise that a review is undertaken to confirm that any termination payments are not viewed as being in anticipation of retirement. This is because if a termination payment relates to an employees retirement, there is no exemption available and the full amount should be subject to tax and Class 1 NICs. In this situation, as all of the employees (except Bill) have confirmed that they wish to continute to work, it is unlikely the payment will be viewed in this regard. However, I advise that HMRC are approached to confirm that they are in agreement that the termination payments do not form part of a retirement payment and that the £30,000 exemption can apply.

Bill

As Bill has been deemed as having a long-term disability, if the Company are to terminate his contract as a result of the disability then any termination payment can be paid exempt from tax and NICs. However, I advise that legal advice from an employment law perspective is obtained to ensure that Bill's departure fully meets this criteria.

Private Medical Insurance Benefit

On the basis that the private medical insurance benefit is to continue for the employees, the employees will remain liable to tax on the value of the benefit. They will be taxed on the value of the benefit in the year that it is received - and I advise the Company to write to HMRC to confirm the taxable amounts for each tax year on the individuals in receipt of the benefit. Rance Grey Motor Media Ltd should also account for the Class 1A NICs that will arise on the value of the benefit in each of the tax years that the individuals continue to receive it before it ceases to be a trading company.

Company Car

I note that the employees have historically been offered a company car or a cash allowance of £6,500. Under the optional remuneration rules, the value of the benefit should be calculated based on the maximum of the cash foregone, or the cash value equivalent for the use of the company car - and it is the higher figure that should be reported on the Form P11D. In Oliver's case, the amount reported on his Form P11D is less than £6,500 and this will need to be corrected to ensure that HMRC include the correct value in Oliver's 2021/22 tax code.

I therefore recommend that before the winding up of the company, Rance Grey Motor Media Ltd contact HMRC to amend the incorrect Form P11D and ensure the correct value of £6,500 is reported. Please note that HMRC can levy penalties of £3,000 per incorrect P11D and additional penalties based on the amount of tax and NICs that was underpaid as a result of the incorrect submission - therefore I recommend that the ommission is corrected as soon as possible so that the disclosure can be unprompted (which reduces the maximum potential penalties that HMRC can levy).

With respect to any discounts made on selling the cars to the individuals, any discounted amounts will be a taxbale benefit within the termination package and will need to be subject to income tax and Class 1A NICs to the extent it exceeds the £30,000 exemption.

Restrictive Covenant

Please note that a restrictive covenant will always be a taxable termination payment and cannot be included in the £30,000 exemption. It will need to be subject to tax and Class 1 NICs.

PAYE

The payment of the taxable elements of the termination package will need to be subject to PAYE. Please note that if the payments are made after the individual has received their Form P45, the payroll team will need to apply a 0T code - and our payroll team will be happy to advise on the transaction if this is required.

Comparison: Option One vs Option Two

Timetable

I note that Freya has suggested that the termination of the employees' contracts could end before the Christmas break. If this is the course of action that the Company wish to take, I advise that the formal notice is given to the employees 3 months prior to this date. This will reduce the amount of PENP that is included in the termination package - as they would work their notice period and could be paid as usual. From a taxation perspective, the timing of the payment should not have a significant impact.

Termination Package

The tax treatment of the termination packages will differ. This is because Option 1 is a structured termination package, and therefore the amounts that do not relate to PENP that fall within the scope of S401 are not subject to tax and NICs (Appendix One).

Whereas, under Option Two - the bonus will be seen as an additional salary payment and the whole amount will need to be subject to tax and Class 1 NICs. This will need to be paid alongside the three months notice between December and February -

and therefore the entire amount is subject to the standard PAYE and Class 1 NICs and is not eligible for any reliefs/exemptions.

<u>Calculations</u>

As per the calculations included in Appendix Three, each employee who is subject to the standard termination rules will receive a net pay of £49,381 for Option One's termination package. However, under Option Two the employee will receive the net amount of £38,738. This means under Option One, the employee will receive an additional £10,643.

In addition, the total cost of Option One to the employer is calculated to be £66,062 - which is made up of the total payments plus employer NICs liabilities (Appendix Four). Whereas, for Option Two - by considering the salary as well as the bonus, the total cost of the package to the employer is £72,506. This means that the total amounts of cost saved per employee is £6,444.

<u>Other Aspects of Consideration</u>

Although by electing to offer Option One as the termination package it results in a higher amount of net pay receivable by the individual, and a lesser amount payable by the company, this option has a significantly greater administrational impact - as there are lots of different treatments for the different payments. The Company should therefore consider whether this is of more importance when determining which package to opt to provide to those being terminated.

It should also be noted that neither of the packages currently consider making a pension contribution to the individual's pension schemes. If this is something that the terminated employees would be happy for, I recommend that this option is considered - as pension contributions can be made exempt from tax and NICs obligations. This would also benefit all of the individuals who are nearing pension age - especiallly Harry, Bill and Rebecca who are of the age in which they are able to access the pesnion. Financial advice should be obtained by both the Company and the individual in this respect, to ensure it is the right move for everyone involved.

Recommendations

Based on there being no change to either termination package, I recommend that Option One is the package that is offered to the employees - and this is because it will result in a higher amount of net pay for the individual and will cost less per person from the company's perspective.

Before entering into an agreement for the package, I recommend that a review of the notice period is undertaken to confirm whether this can occur any earlier - and also to alter the formal notice date to be 3 months before the employees stop working for the company, as this will reduce the PENP taxable within the termination package (as it will be taxed as standard salary).

In addition, I advise the Company to seek financial advice in relation to paying a portion of the termination package as a pension contribution - to reduce the tax and NICs that are due on the payment. If this is an option that the Company is interested in applying, attention may need to be paid to the annual and lifetime allowances for each individual - and we will be happy to perform a review of this if it is required.

Additional Considerations

<u>Legal</u>
I recommend that employment law advice is obtained ahead of the termination of the employments.

I note that all of the senior staff are being made redudant and the more junior staff are being offered new positions with Rance Grey Ltd. This will need to be reviewed as it may be deemed to be age-related discrimination. If any of the individuals deem this to be the basis behind their termination and claim that they have been unfairly dismissed, the Company could be taken to Court to claim compensation in respect of this. This is particularly important as a formal selection process has not been carrie out - and therefore there appears to be scope for the employees to claim that they have been unfairly dismisssed.

In addition, the restrictive covenant clause that is being included in the termination package should be reviewed by a legal professional to ensure that this meets the employment law criteria for these forms of payments. Typically, restrictive covenant provisions are allowable if the employer has a legitimate business interest to protect - and this may not be deemed to be the case as the Company is ceasing to trade. On the other hand, it may be considered a required option following the past experience with Grange Toms - so a review is required in order to determine the legality of the clause.

Rance Grey Limited will need to ensure that the transfer of the junior staff is lawful - and remains compliant with employment law legislation. It is possible that the staff who are being terminated may claim discrimination as they have not been offered a role with Rance Grey Ltd and advice should be taken in this regard to ensure that they are not taken to court and subjected to a compensation fine.

The Company will need to ensure that it complies will the administrational requirements upon the winding up of the Company, for example informing Companies House so that it may be struck off the register.

Corporation Tax

As the Company is a 100% subsidiary of Rance Grey Ltd (therefore Rance Grey Ltd has at least 75% ownership) then there is an option to claim group relief from a corporation tax perspective for any losses that the Company has carried forward. In the first instance, the Company must surrender the trading losses against their profits made in the period 1 January 2021 to 31 March 2022 - which will utilise £32,000 based on the accounts provided (although this is subject to change when the accounts have been reviewed). The remaining £288,000 in unutilised losses will need to be analysed to determine the amounts incurred after 1 April 2017 - as it is only from this date that losses can be carried forward for group relief purposes. Rance Grey Ltd will only be able to utilise the unsued losses to the extent that the amount does not receive the deductions allowance plus 50% of its unrelieved profits.

On a separate note, I note that the wages and salaries expenditure has accrued for the anticipated redundancy costs. Statutory redundancy pay is an allowable deduction for Corporation Tax purposes - and the maximum statutory redundancy payment each individual can receive is £16,140. However, as the Company is ceasing to trade, a further deduction is only allowable if the termination package is three times the amount of statutory redundancy or less. Based on the figures provided that the statutory redundancy would have been £10,000 - then this means a further deduction would not be available from a corporation tax perspective - as the package exceeds £30,000 in termination payments. This should therefore be added back to the arrive at the total taxable profits. Please note that if the bonus (Option Two) package is opted for - these amounts will be deductible as per the normal rules for salary and NICs payments.

<u>VAT</u>

Please note that if the Company is included in a VAT group with Rance Grey Ltd, HMRC will need to be informed to confirm that the

Company is no longer part of the VAT group. However, on the basis that they do form part of a group, the transfer of the supplies will not generate a VAT charge.

Personal Tax

Under the Company's pension scheme, employees may start to receive pension benefits at the age of 55. As three of the employees' who's position is being terminated are of this age, I recommend tax advice is taken to determine the tax treatment of any payments or lump sums that are received from the scheme.

In particular, Bill should obtain advice as he is under 75 years old and has serious ill-health, therefore he may be entitled to a lump sum on the basis his fund is within the lifetime allowance.

Appendices

Appendix 1 - Tax Treatment for Option One

	Taxable	Non-Taxable
Salary during notice period (W1)	17,105	
Redudancy pay		20,000
Additional termination payment (W2)	14,084	10,000
Restrictive Covenant	500	
Total	31,689	30,000

Appendix 2 - NICs Treatment for Option One

	Class 1	Class 1A	No NICs
Salary during notice period (W1)	17,105		

Redudancy pay		
20,000		
Additional termination payment (W2)		14,084
Restrictive Covenant	500	
Total	17,605	14,084
20,000		

Appendix 3 - Comparison of Employee Net Position

	Option One	Option Two
Total received (W3)	61,689	50,000
Tax (W4)	(11,634)	(18,958)
EEs NICs (W5)	(674)	(1,322)
Net salary (W6)		9,018
Total	49,381	38,738

Appendix 4 - Employer's Costs Option One vs Option Two

NICs	Option One	Option Two
Amounts subject to Class 1 NICs	17,605	50,000
Amounts subject to Class 1 A NICs	14,084	
Total	31,689	50,000
@13.8%	4,373	6,900
Package	61,689	50,000
Salary (W7)		15,606
Total ER costs	66,062	72,506

Workings

W1 - (65,000 x 100/95) x 3/12 = 17,105

W2 - 30,000 - 20,000 = 10,000
24,084 - 10,000 - 14,084

W3 - Option 1: 17,105 + 20,000 + 24,084 + 500 = 61,689

W4 - Option 1:

Taxable termination payment	31,689	
Less: Personal allowance (12,500 x 1/12)	(1,042)	
Taxable amount	30,647	
Basic rate tax (37,500 x 1/12) @ 20%	3,125	£ 625
Higher rate tax (30,647 - 3,125)@ 40%	27,522	£11,009
Total		£11,634

Option 2:

Taxable termination payment	50,000	
Less: Personal allowance (12,500 x 1/12)	(1,042)	
Taxable amount	48,958	
Basic rate tax (37,500 x 1/12) @ 20%	3,125	£ 625
Higher rate tax (48,958 - 3,125) @ 40%	45,833	£18,333
Total		£18,958

W5 - Option 1:
EEs NICs 17,605

(4,167 - 792)@ 12%	£405
(17,605 - 4,167) @ 2%	£269
Total EE NICs	£674

Option 2:

(4,167 - 792) @ 12%	£405
(50,000 - 4,167) @ 2%	£917
	£1,322

w6 - Salary Dec - Feb:

(65,000 x 100/95) x 3/12 = 17,105

Total salary	17,105
PA (12,500 x 3/12)	(3,125)
Taxable	13,980

Basic rate (37,500 x 3/12)@ 20%	9,375	£1,875
Higher rate (13,980 - 9,375)	4,605	£1,842
Total tax		£3,717

(4,167 - 792) x 3 x 12% =	£1,215
(13,980 - (4,167 x 3)) x 2% =	£ 30
Total Class 1 NICs	£1,245

EE net salary: 13,980 - 3,717 - 1,245 = 9,018

W7 - ER cost of Dec - Feb salary:

(13,980 - (732 x 3) x 13.8% = 1,626

£1,626 + £13,980 = £15,606