The Chartered Institute of Taxation

Application and Professional Skills

Human Capital Taxes

May 2021

Suggested answer

Draft report to Jinny Barbayas (HR Director) and Freya Archibald (Finance Director) of Rance Grey Ltd relating to the redundancies at Rance Grey Motor Media Ltd.

Introduction

This report has been prepared to provide advice relating to the closure of Rance Grey Motor Media Ltd and in particular to comment on the two options for structuring the termination packages as follows:

Option 1: to split out the components of the termination package to the combined value of £50,000 per employee

Option 2: to pay a termination bonus of £50,000 per employee

This report will include:

- the PAYE & National Insurance (NI) obligations for termination payments
- the Corporation Tax considerations
- the employment law considerations for the employees leaving and those transferring to Rance Grey Ltd

Our advice is based on the information provided by you and is valid by reference to the tax legislation in place on today's date. If any of the information has subsequently changed or our understanding of the position is incorrect, please let us know as this may affect the tax advice provided. The report is intended for the use of Rance Grey Ltd only.

Executive Summary

We recommend that Option 1 where all the items are separately listed. This offers the most tax and NI efficient outcome for both Rance Grey Motor Media Ltd and the employees. This will prevent additional costs which would be faced under Option 2 for each employee comprising tax of £11,886, NI of £875, and employer NI of £4,100.

We recommend Option 1 is amended to include the actual amount of statutory redundancy pay each employee is entitled to as this will also have an impact on the amount of corporate tax deduction is available.

We also recommend that the pension salary sacrifice is included in the payment in lieu of notice (PILON) calculations.

We recommend that contributions are made into employees' pension schemes to reduce the amount liable to Class 1a NIC, although independent financial advice and advice from your pension administrators should be sought.

Whilst there are no advantages to paying the redundancy payments early, we recommend that you bring forward the process for Bill. He is entitled to full tax-exemption on disability payments as he is no longer able to carry out his duties.

Clearance from HMRC should be requested as there is time before the payments are made and a potential risk that HMRC could challenge the redundancy given the employees are at or approaching retirement age. This will ensure HMRC agree to the £30,000 exemption.

We also recommend written compromise agreements to reduce the risk of tribunal claims as well. Employees should be allowed to claim the costs of independent legal advice on their compromise agreements.

Reporting would be needed to HMRC for termination payments and benefits in kind provided post-employment by 6 July 2022.

Oliver's P11D for 2020/21 should be amended before 5 July 2021 to show the cash forgone of £6,500 instead of the lower company car benefit. Any earlier years' P11D prepared in the same way should be amended through a voluntary disclosure to HMRC.

Our Analysis

Redundancy or Retirement

Firstly, we must consider whether payments could be construed as payments on, or in anticipation of, retirement.

If no third party is involved in the arrangement, a retirement payment directly made by the employer is taxable as an Employer Financed Retirement Benefit Scheme (EFRBS); a non-registered pension scheme. This prevents the £30,000 exemption available for redundancy payments.

"Retirement" has no statutory definition; the facts are reviewed to see if employees are "retiring" from work. If there is no dismissal (including redundancy), then MRC can consider a payment for retirement. Whereas for dismissals HMRC are likely to accept that the payments are compensation for loss of office.

Apart from Bill, you have told us that the employees are fit and healthy and seeking new roles in similar professions so implies “dismissal” even though some are entitled to pensions at age 55. HMRC often challenge redundancy payments where employees are close to retirement age so we suggest that a ruling is sought in advance from HMRC.

For Bill, redundancy payments made on the grounds of disability or injury are outside of EFRBS and can be paid tax and NI-free. You may wish to give Bill notice and pay his redundancy in full now as he will not be able to return to work. His salary would remain liable to UK tax and NI as general earnings.

Comparison of Options

Whilst the two options total £50,000 they differ as follows:

Option 1: the component parts are:

Payment in lieu of notice	£5,416
Enhanced Redundancy Pay	£20,000
Additional termination payment	£24,084
Restrictive Covenant	£500
Private medical insurance cover until 30 June 2022	

Option 2: £50,000 paid as a termination bonus.

Option 1

Items which are earned or contractual are general earnings liable to tax and NI. Qualifying non-contractual compensation for loss of office is tax and NI-free up to £30,000. The excess above £30,000 is liable to tax and employer’s Class 1A NI only.

Salary and any un-used holiday pay are contractual and liable to tax and Class 1 NI.

Payment in Lieu of Notice

If full notice periods are not worked employees may be due payment in lieu of the un-worked notice; “PILONs”. From April 2018 regardless of whether the company reserves the right to make PILONs, all PILONs are liable to tax and NI as general earnings.

From April 2018, legislation introduced the calculation of PILONs called Post Employment Notice Pay (“PENP”).

We understand employees sacrifice 5% of salary for pension so the sacrifice needs to be added back for the unworked notice period. The car allowances do not need to be included as part of basic pay in the PENP calculation.

For example, if Rebecca’s notice ends on 28 February but her last day working is 31 January she is entitled to a PILON for one month. The PENP calculation is as follows:

Monthly Salary £65,000/12	£5,416
Uplift for 5% salary sacrifice £5,416 x 5/95	£285
Contractual entitlement per month	£5,701
Notice period x 3 months £5,701 x 3	£17,103
Less: Notice period worked £5,701 x 2 months	£11,402
Amount due as PENP	£5,701

The total amount due is £5,701. You may wish to reduce the total enhanced redundancy to limit the total payment of £50,000 per employee.

Enhanced Redundancy

Enhanced redundancy does not automatically imply qualifying payments; we have to consider whether they are contractual earnings or compensation for loss of office.

Your standard employment contracts do not include a termination clause. As no termination or redundancy payments have been made to date, HMRC are unlikely to challenge that employees have a contractual right or reasonable expectation to receive any sums of money on redundancy.

Assuming HMRC accept the payments are not retirement payments, the enhanced redundancy would therefore qualify for the £30,000 exemption.

Additional termination payment

First, we have to consider whether this additional payment would be general earnings liable to tax and NI or payments made by reason of redundancy, where it is necessary to establish there is no entitlement and employees are not required to carry out certain duties in order to receive the payment.

There is no performance criteria or reward element in this payment and employees do not have to perform certain duties to qualify. You consider this to be an additional redundancy payment and we believe these are not earnings as the employees would have no legal recourse to these payments. This means that this payment would benefit from the balance of the £30,000 exemption. The excess would be liable to tax at the employees' marginal rates.

We recommend that you document how the overall enhanced redundancy payment has been calculated and that the payments are not earned in any way by reference to past, current or future duties.

Restrictive Covenants

Payments for new restrictive covenants are fully liable to tax and NI as payments in recognition of activity (or lack thereof) albeit after the employment has ended.

Whilst it is typical to include restrictions placed on an employee's actions after their employment ends, such as confidentiality, any payment specifically for a new restrictive covenant would be liable to tax and NI as general earnings. You may wish to take advice from your employment lawyer to ensure that the payment attributable to the restrictive covenant is appropriate.

Private medical insurance

You state that employees will remain in your company private medical scheme following redundancy, however, we recommend you check whether the scheme remains open for former employees and a ceased business. If it's possible for employees to remain in the scheme post termination, any premiums relating to the post-employment period could be considered as enhanced redundancy but as the £30,000 has been used, they would remain taxable in the year of payment.

Option 2

This option is a single termination bonus of £50,000.

A bonus relating to prior service and performance would be general earnings and be liable to tax and national insurance. This includes any element relating to the restriction. The bonus would not qualify for the £30,000 exemption.

Below is a comparison of the calculation of tax and NI on the cash items assuming the employees are higher rate taxpayers:

Option 1	Tax	Employee's NI	Employer's NI
Payment in lieu of notice £5,701 liable to tax and Class 1 NI	£2,280.40	£114.02	£786.74
Enhanced Redundancy £20,000 all included within £30,000 exemption	£0.00	£0.00	£0.00
Additional termination payment £10,000 included within £30,000 exemption and remaining £14,084 liable to tax and Class 1A NI	£5,633.60	£0.00	£1,943.59
Restrictive covenant £500 liable to tax and Class 1 NI	£200.00	£10.00	£69.00
Total	£8,114.00	£124.02	£2,799.33

Option 2	Tax	Employee's NI	Employer's NI
Termination Bonus £50,000 liable to tax and Class 1 NI	£20,000.00	£1,000.00	£6,900.00
Difference in Option 1 and 2 per employee	£11,886.00	£875.98	£4,100.67

If considering Option 2 you would also be obliged to make PILON payments, however, these could be part of the £50,000 payment.

Whilst we appreciate Option 2 has merits in making the paperwork simpler and potentially saving on some employment law costs, the increased tax and NI to the employees and Rance Grey Motor Media Ltd means the costs are prohibitive and is not recommended. You should also note the comments below about employment law matters.

Conclusion - Comparing Option 1 and Option 2

We recommend Option 1 with the additional uplift of PILONs for pension sacrifice and car allowance where applicable as this provides better net pay for the employees and a reduced cost to you. This option provides better clarity than Option 2 which, by combining all component parts as a "bonus" would result in the payment being liable to tax and NI.

By selecting Option 1 this will enable greater clarity for HMRC, your employees and your payroll team to correctly process each payment for tax and NI as well as savings of £16,862.65 per employee.

Other Considerations

Looking at other items being considered as follows:

Statutory redundancy

The current maximum statutory redundancy is £16,320, however, based on the years of service and ages of the employees it's possible that they are entitled to more than the £10,000 estimated.

We recommend that you seek employment law advice to accurately calculate the amount of statutory redundancy for each employee. Whilst this may not have an effect on the overall value of the package, you should ensure that each employees' settlement accurately reflects their entitlement to statutory redundancy.

Company Cars

If Harry and Oliver buy their company cars from you, any discount would be part of their redundancy package and liable to tax and Class 1A NI as the £30,000 exemption has been used.

We note that employees are offered a cash alternative of £6,500 whereas for Oliver his company car benefit included on his 2020/21 P11Ds is lower at £5,600. Where employees have the choice to receive either a company car or a call alternative, optional remuneration ("OpRA") rules apply which seeks to tax the higher of the benefit in kind or the cash forgone.

If you have not yet submitted your P11Ds for 2020/21 Oliver's should be amended to include the £6,500 cash forgone. This will apply to any other employee in this situation and also for the P11D for the car benefits up to termination. The P11D(b) should also be amended to ensure the correct Class 1A NIC is paid.

If earlier years' P11D have the same error, we recommend making a voluntary disclosure to HMRC in order to pay the additional Class 1A NIC. This will impact the tax employees pay on their self-assessment tax returns. Interest and penalties may be incurred for submitting incorrect P11Ds, however, penalties are likely to be mitigated by the voluntary disclosure.

Pension Contributions

It is tax efficient to divert part of the payments into a pension scheme especially for those close to retirement age. A 25% tax-free lump-sum can be withdrawn at retirement. We recommend you discuss this with your employees.

Annual and lifetime limits will apply so your employees should seek financial advice and also you should seek advice from your pension scheme administrators. We are not authorised to provide investment advice.

Timing and Payroll Actions

If you provided notice to your employees earlier, more PILON would be paid instead of regular pay. There would be no difference in the cost of this to Rance Grey Motor Media Ltd, however, employees would not suffer 2% NI on PILONs whereas they would on salary payments.

Accelerating the payment would have no effect as both would fall into 2021/22, however, there are advantages for employees if redundancy occurs early in 2022/23 allowing more taxed at basic rate of tax. This would work well if there were a delay before starting another employment, however, more salary would be accrued for the employees so this would cost more.

Ideally, if termination payments are made in the last payroll run for the employees the P45 will include all payments from the employment using the employee's normal tax code. This approach is recommended.

If the payments are made after the issue of P45s, PAYE should be operated on all taxable items plus any excess over £30,000 using tax code 0T on a week 1/month 1 basis. The 0T code does not give the benefit of any personal allowances which could mean an incorrect amount of tax is deducted from the employees.

From April 2020, this excess over £30,000 is also liable to employer's Class 1A NI at 13.8%. For termination payments, Class 1A NI needs to be accounted for through RTI at the same time as PAYE. Class 1 NI remains applicable for general earnings, PILON and covenants.

For the employees joining Rance Grey Ltd, they should be issued with a P45 when leaving Rance Grey Motor Media Ltd and set-up as new employees on your payroll. You should ensure that P11Ds are also completed for the whole year under each respective PAYE reference. We recommend you also speak with your pension advisers about moving these employees onto your pension scheme.

Employment Law Aspects

We recommend you seek employment law advice to ensure you follow a fair and reasonable process. It would be necessary to ensure that your reasons for selecting the employees to be made redundant are fair and aspects such as age discrimination has not been inadvertently included in the selection of the employees to be made redundant. It is important that your decisions are not discriminatory or construed as unfair to any particular employee which could lead to grounds for unfair or constructive dismissal. It is also worth considering if there are opportunities for redeployment in your overseas businesses.

We recommend that compromise agreements are used where employees agree to the terms of the settlement. This reduces the risk of employees claiming against the company in an employment tribunal. It provides clarity on payments and restrictions thereby reducing the risk of misunderstanding by the employee or HMRC. Were you to pay a bonus under Option 2, it is not clear that you have paid any statutory redundancy and the employees could still have grounds to sue you for redundancy pay or unfair dismissal. Your employment lawyer will be able to provide more guidance for your compromise agreement and support you with the consultation process and employee communication. Your employment lawyer will also be able to advise you on the transfer of employees to Rance Grey Ltd and what action should be taken regarding their contracts of employment and any changes to terms and conditions.

Legal Support

We recommend that you pay for employees to take legal advice on their redundancy packages, especially as you are asking them to sign a compromise agreement. Employees would engage a lawyer of their choosing and arrange for the invoice to be sent to you for payment. When this is included within the compromise agreement, this is specifically exempt from tax and NI and you may wish to set a limit of say £300 as a maximum amount which may be reimbursed and potentially pay less enhanced or additional redundancy payment.

Outplacement Services and Retraining Courses

We recommend you consider paying for outplacement services. These can be delivered tax-free to employees to provide a specific level of support in finding alternate employment, set-up their own businesses or prepare for retirement. If you would like any recommendations for providers in this field please let us know.

A similar tax-free provision for retraining courses is available, these are designed to impart skills to aid employees' future employment prospects. You may wish to offer outplacement and retraining to employees instead of some of the enhanced redundancy pay. This would reduce the tax payable by the employees as well as a small reduction employer's NI.

Reporting

Benefits in kind

Benefits such as medical insurance and company cars provided during employment should be reported on P11D as normal.

Post-employment benefits would need to be reported separately to HMRC separately to P11D benefits.

Reporting to HMRC

A one-off report needs to be filed by 6 July 2022 because the termination packages will exceed £30,000 and include non-cash benefits. Any taxable payment will be reported on a Full Payment Submission under RTI.

Reporting must contain:

- total value of the package, split between cash and benefits
- cash payments and benefits provided in the current year and estimates to be provided in the future, stating how long the arrangements are expected to last and the terms under which they will be paid

If there is a variation in the package by an increase exceeding £10,000 either in cash or non-cash benefits a further report must be submitted by 6 July following the year of variation. Penalties of up to £300 may be charged if the report is not submitted, together with an additional penalty of up to £60 per day from when the £300 is charged until the report is filed.

Corporate Tax Aspects

Deductions

Any payments made at the point of redundancy which are taxed as general earnings, for example, salary and holiday pay would be deductible from profits as normal.

A deduction is allowed for termination payments if they meet the normal test of wholly and exclusively for the purposes of the trade. Whilst this test may be difficult to meet as Rance Grey Motor Media Ltd is ceasing to trade, the deduction is limited to the statutory redundancy plus three times statutory redundancy per employee.

As mentioned above if statutory redundancy is estimated at £10,000, this would limit the corporate tax deduction to £40,000 per employee. Alternatively, as up to £16,320 statutory redundancy per employee is possible this could give a higher deduction over £64,000. We recommend that the exact amount of statutory redundancy is calculated to maximise the corporate tax deduction.

Freya asked whether there was an opportunity to make the termination payments from Rance Grey Ltd instead of Rance Grey Motor Media Ltd. As the employees are working for Rance Grey Motor Media Ltd there is no benefit in making the payments from Rance Grey Ltd as they would not be deductible for corporation tax. It is strongly recommended that Rance Grey Motor Media Ltd make the termination payments to the employees.

Group Relief & Timing of Redundancy Payments

We understand that Rance Grey Motor Media Ltd is expected to make a small profit in the final period of trading so you should offset the brought forward losses firstly against this profit. As Rance Grey Ltd owns 100% of Rance Grey Motor Media Ltd the remaining losses are available to Rance Grey Ltd, however, as part of the carried forward losses are from 2015, any made in the accounting periods beginning before 1 April 2017 are not available for surrender and would be lost unless any part of the trade of Rance Grey Motor Media Ltd is continued.

Long Accounting Periods

As you intend the Rance Grey Motor Media Ltd accounts for the final period to be longer than 12 months, from 1 January 2021 to 31 March 2022, for Corporation Tax purposes you should split the taxable profit into two accounting periods. This will be for the 12 months ended 31 December 2021 (or to cessation of trade if earlier) and for the three months ended 31 March 2022. The profit should be time apportioned but separate calculations would be needed for any capital allowances for the purposes of calculating the tax payable in each period.

Forms CT600 should be submitted together with financial statements and corporation tax computations for each period within twelve months of the period end.

Transfer of Assets to Rance Grey Ltd

We understand that the remaining assets of Rance Grey Motor Media Ltd are going to be transferred to Rance Grey Ltd. This is a mixture of stock and office and IT equipment.

As the companies are within the same group the equipment can be transferred on a no gain no loss basis. It should be transferred to the balance sheet of Rance Grey Ltd at it's written down value.

On the assumption that Rance Grey Ltd will hold the stock as trading stock this will be transferred at no gain no loss. If they will hold the asset as a capital asset, then Rance Grey Motor Media Ltd will be treated as making a disposal from trading stock at market value prior to the transfer.