

OFFICE OF TAX SIMPLIFICATION PROPOSES REMOVAL OF £30,000 TAX- EXEMPT TERMINATION PAYMENTS

On 31 July 2014, the Office of Tax Simplification (“OTS”) published its final report into the review of taxation of employee benefits and expenses. That final report suggested the removal of the £30,000 tax exemption for compensation payments on termination of employment.

The current rules have been criticised for being misleading and confusing, leaving some people under the false impression that the first £30,000 of any termination payment will be tax-free. The tax relief does not automatically apply to all payments on termination. The circumstances and nature of the payment need to be considered to establish which part, if any, is exempt from tax. For example, if the payment derives from the employment contract (holiday pay, bonus, notice pay etc), it is taxable in the normal way (refer to our Factsheet)

PROPOSED CHANGES

The OTS has suggested that the current £30,000 exemption should be replaced with a new income tax relief that is available for statutory redundancy. It is suggested that all payments that are received in a redundancy situation would be combined and subject to an exemption up to the value of the exemption. The value of the exemption would be a multiple of the statutory redundancy payment to which the individual is entitled and would apply regardless of the nature of the payment or whether there was a right to the payment in the employment contract.

This would, however, mean that certain termination payments that benefit from the tax exemption would cease to do so. For example, unfair dismissal awards, damages for wrongful dismissal and discrimination payments to compensate for financial loss. The government may also consider exempting these payments from tax, given that they are often paid when an individual has lost their job.

ALTERNATIVE SOLUTIONS

The OTS has also suggested increasing (rather than removing) the £30,000 exemption in line with the retail prices index to approximately £71,000 and/or replacing the current £30,000 exemption with a blanket exemption for all payments made on termination.

Even if these proposals are accepted by the Government, the OTS commented that they are not likely to be introduced in the near future. In the interim it is likely that HMRC will improve its guidance on when tax relief can be applied on termination.

