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Newsletter October 2016

UK Employment Update

Welcome to our October Update in which we consider the consultation on the tax treatment of termination payments that was published whilst many of us were enjoying our summer breaks. The proposed changes are intended to simplify matters but in practice it is questionable whether the current proposals will in fact cause more complexity. We also take a look at the duty to make reasonable adjustments for disabled employees and whether this can ever require an employer to maintain an employee's existing rate of pay if they are redeployed into a lower paid role. On the horizon is the possibility of employee board representation as evidenced by the recently launched inquiry into corporate governance.

Tax treatment of termination payments: all change

Over the summer the Government has been consulting on proposed changes to the tax treatment of termination payments. It is intended that the new tax regime will come into force in April 2018.

Payments in lieu of notice (PILON's)

It is proposed that all pilons will be liable to tax and national insurance contributions (NICs) regardless of whether there is an express pilon provision in the departing employee's contract.

At present if there is a pilon clause in the contract then the pilon payment will be taxable as earnings and subject to NIC's. If there is no pilon clause in the contract and the employee is terminated without notice then, in principle, the pilon is liquidated damages for breach of the contractual notice provision. As such it is a payment in connection with the termination of employment and therefore only subject to tax to the extent it is exceeds £30,000.

In practice there has sometimes been some confusion as to the tax treatment of a pilon in cases where there is no pilon clause in the contract but the employer has an established practice of making such payments. HMRC has in some cases taken the view that such pilon payments should be treated as earnings and taxed as such (rather than as payments in connection with termination) on the basis that the pilon payment is an integral part of the employer-employee relationship and is therefore earnings even though non contractual.

National Insurance Contributions (NICs)

At present neither employer nor employee NIC's are payable on termination payments. Under the new regime it is proposed that employees will continue to be exempt from NIC's.

Employers however will be liable to employer's NIC's on the balance of any termination payment exceeding £30,000. In cases where a substantial termination payment is agreed this will give rise to a significant additional cost to the employer.

Key issues

- Tax treatment of termination payments: all change
- Disability discrimination: maintaining existing rate of pay in new role can be a reasonable adjustment
- Worker representation on boards: first steps initiated

Additional changes

The foreign service exemption that reduces or removes any liability to tax on termination payments made to employees with the requisite foreign service will be repealed.

The new legislation also clarifies that the exemption from tax in relation to compensation for personal injury does not include compensation for injury to feelings unless they amount to a psychiatric injury or other recognised medical condition. This is welcome as there are currently conflicting views of the Upper Tax Tribunal and Employment Appeal Tribunal on whether compensation for injury to

feelings payable on termination of employment is exempt from tax.

Statutory redundancy payments

Statutory redundancy payments and unfair dismissal awards will continue to be exempt from tax up to £30,000.

Potential areas of uncertainty

Under the new regime the legislation essentially splits termination payments into two categories those that can benefit from the £30,000 exemption to tax and those that are classified as 'general earnings' that must be treated for tax purposes like salary and benefits in kind. In the latter category is 'expected bonus income'. This is defined to include ' a payment or other benefit by way of a bonus that the employee could reasonably be expected to receive' by reference to the employment and in respect of times before the end of employment (or notice period if it had been worked) were the employee to continue in employment long enough to receive it.

The intention appears to be that if the employer makes an ex-gratia payment in relation to loss of a bonus as part of any termination package the employer is expected to calculate the bonus the departing employee could reasonably be expected to receive and that element of the termination payment would be liable to tax and NICs as earnings.

There is scope for this approach to give rise to some degree of uncertainty. If this proposal is implemented it remains to be seen whether HRMC will routinely seek to challenge the nature of a termination payment; arguing that all or part of it is attributable to such 'expected bonus income' and therefore liable to tax and NICs rather than taxable only to the extent it exceeds £30,000. In cases where employers operate discretionary bonus schemes or where no bonus is payable if an employee is under notice or where the employee leaves at a point in the bonus year where it is not possible to ascertain what or whether a bonus is payable how can the amount of 'expected bonus income' be assessed? Where the bonus scheme is completely discretionary it is also difficult to see how HMRC can then assert that some of the compensation payment is attributable to an expected bonus absent an express provision to this effect in any settlement agreement.

The consultation can be found here: ***https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/545135/Simplification_of_the_tax_and_National_Insurance_treatment_of_termination_payments-government_response_and_consultation_on_draft_legislation.pdf***

Disability discrimination: maintaining existing rate of pay in new role can be a reasonable adjustment

Employers are under a statutory duty to make a reasonable adjustment if a provision, criterion or practice puts a disabled employee at a substantial disadvantage. This duty can arise in circumstances where an employee's disability is such that they are no longer able to perform the role for which they were recruited and would otherwise be liable to be dismissed.

It is clear from the case law that a reasonable adjustment in such circumstances can be the transfer of the disabled employee to an existing vacancy. This may even be to a higher grade role without a competitive interview.

Where the vacant role is paid at a lower rate is the employer also expected to maintain the original higher rate of pay as part of its reasonable adjustment duty? This was the issue considered by the Employment Appeal Tribunal (EAT).

P was unable to perform his job due to a back condition which amounted to a disability. In accordance with its duty to make a reasonable adjustment P's employer transferred him to a new role that was paid at a lower rate of pay to avoid dismissing him. P was however paid at his normal rate of pay for one year in this new role.

The EAT considered whether it was reasonable for the employer to have to place P in the new role while keeping his existing pay. It acknowledged that many reasonable adjustments can give rise to additional cost to an employer, for example, the provision of additional equipment or training, maintaining existing rates of pay was no more than another form of cost so there was no reason to differentiate it from other adjustments. In its view in principle it could be a reasonable adjustment to protect an employee's pay in conjunction with a move to another role. In practice whether it is reasonable will depend on the factual matrix applicable to the employer.

The EAT held that it would be relatively unusual for an employer to be required to make up an employee's pay long term to any significant extent but this could be a reasonable adjustment and was a reasonable adjustment in the case of P. Factors that were taken into account when considering whether it was reasonable included the fact that there was no established pay scale in relation to the role so the employer had a free hand in determining it and that the employer had substantial financial resources. The argument that other employees would be discontented was dismissed as an unattractive reason for not making such an adjustment.

It was also acknowledged by the EAT that in some case what was once a reasonable adjustment can cease to be so due to a change in circumstances, for example the need for a job might disappear, or, the economic circumstances of a business may change.

Employers considering offering alternative roles by way of reasonable adjustment should bear in mind the following points emerging from this decision:

- If a reasonable adjustment is not

compatible with the employee's existing terms and conditions, for example in relation to rate of pay, hours or location, it cannot simply be imposed on the employee as it amounts to a variation of the contract.

- The employee's express consent to the variation of the contract must be secured. Ideally the agreed variation should also be expressly recorded in writing.
- Maintaining the original rate of pay indefinitely or for a transitional period can be a reasonable adjustment in some cases.
- Clear evidence of why maintaining the existing rate of pay is unreasonable will be required from an Employment Tribunal.

[Cash Solutions (UK) Ltd v Powell]

Worker representation on boards: first steps initiated

Following the Prime Minister's leadership campaign speech in which she proposed to 'put people back in control' and to get 'tough on corporate responsibility' the Government has launched a corporate governance inquiry as a first step to potentially implementing some of these proposals.

The inquiry covers three broad themes:

- Directors' duties
- Executive Pay
- Composition of Boards

Under the theme of board composition the question of whether there should be worker representation on boards and/or remuneration committees is addressed. It also seeks views on what form should representation should take?

The BIS Committee is committed to exploring how worker representation will work, how many representatives would be added to boards and how they would be selected. However, at this stage the government appears to have no developed views on how employee representation will work. Will employee board representation only apply to large companies employing 250+ or will a lower threshold apply? What sort of representation will apply? Will the representatives have binding or only advisory votes? Will they be eligible to vote and/or comment on all issues?

The inquiry is also considering how to achieve greater board diversity as part of this initiative. There has also been some press suggestion that a further consultation will be launched to explore the possibility of appointing board and non-executive directors to be responsible for employees and board diversity.

It is reported that the TUC is of the view that all firms with more than 250 employees should be required to put worker representatives on their boards.

Written submissions have to be made by 26 October. The terms of the inquiry can be found here:***http://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/news-parliament-2015/corporate-governance-inquiry-launch-16-17/***

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