



## FEATURE ARTICLE

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### **Technical Briefing re Redundancy Payments**

Recently an adviser within Lighthouse Group had a specific query regarding new rules relating to redundancy payments and changes introduced from April 6<sup>th</sup> 2011.

The information provided to the adviser in this respect is given below for general information purposes only (this is not intended as specific advice):

With effect from 6 April 2011, employers can no longer simply deduct basic rate tax (currently 20%) from cash termination payments made to employees **after the issue of their P45**.

New PAYE Regulations came into force on the 6th April 2011 and require employers to use an "OT" code to calculate and deduct tax where the employee's P45 *has already been issued*.

The effect of this change is a potential requirement to deduct basic, higher and additional rate tax from the payment.

#### **Background:**

Where an employer makes a termination payment to an employee, it will normally be required to withhold tax at source in respect of any amounts that do not fall within the tax free qualifying £30,000 exemption provided by section 401 of the Income Tax (Earnings and Pensions) Act 2003 and so tax will be required in respect of any excess over £30,000.

#### **The position prior to 6th April 2011:**

Before April 6<sup>th</sup> 2011 employers were permitted to just deduct basic rate tax (currently 20%) from non-exempt termination payments made **after** the issue of the P45, using the "BR" code.

This was advantageous as it provided a cash-flow advantage to employees who were higher/additional rate tax payers. (The higher rates of tax owed in relation to the taxable sum would



not be payable by the employee until after that employee had subsequently filed their individual self assessment tax return.)

## **The new rules from 6th April 2011:**

HMRC have altered the rules with effect from 6th April 2011, presumably in order to reverse the previous cash flow advantage in its own favour.

The new rules mean that for termination payments made on or after 6th April 2011 where the P45 has **already been issued**, the employer will now have to calculate and withhold tax using a non-cumulative "OT" tax code.

A key aspect of this is that deductions under the "OT" code are calculated by reference to 1/12th of the employee's annual basic, higher and additional rate bands.

## **What does this mean in practice?**

As an example, the PAYE withholdings that now have to be applied to any post-P45 cash payment made in the first month of the 2011-12 tax year ("month 1") are roughly as follows:

- The first £2,916.67 would be taxed at 20% (being **one twelfth** of the £35,000 threshold for the 20% tax band for 2011/12);
- The next £9,583.33 would be taxed at 40% (being **one twelfth** of the £150,000 threshold for the 40% tax band for 2011/12); and
- Any amount above £12,500 would be taxed at 50% (as being over **one twelfth** of the £150,000 top rate threshold).

## **Impact:**

- ✓ The previous cash flow advantage relating to payments made **after the issue** of the P45 has been reversed.
- ✓ The PAYE treatment of payments made **prior to the issue** of the P45 remain unchanged. (Employers are obliged to withhold tax on any non-exempt termination payments at the rates that would have applied had that payment been additional salary/income paid to the employee.)
- ✓ It is no longer desirable (for employees at least) to delay termination payments until after the issue of the P45.
- ✓ Employers should ensure that their payroll operators are aware of the change, so that they operate the "OT" code where necessary going forward.
- ✓ Employers who wish to limit the impact of this change for employees should consider either making the termination payment before the P45 is issued, or staging the payments made after the P45 has been issued over several months.



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