

This factsheet is designed to give an overview of redundancy and the taxation issues regarding this.

What is redundancy?

Redundancy, in general terms, is where an employer needs to reduce their workforce for whatever reason (generally due to budget cuts/lack of income or because a workplace is closing) and the position you are in will no longer be available. If your employer takes on a direct replacement for you shortly after the termination then in actual fact your position was not made redundant. If your employer is actively recruiting for more workers but not to fill the position that has been made redundant i.e. they are recruiting for other areas of the business, then this is acceptable.

What is a redundancy payment?

A redundancy payment is a payment by your (to be) ex employer as compensation where your job has been made redundant through no fault of your own.

How much redundancy pay?

The amount of statutory redundancy payment depends on your age, length of service and contractual earnings (up to a maximum of £430 per week). As a minimum you should receive the following redundancy pay (the statutory minimum) if you have been continuously employed for 2 years or more:

You will get:

- 0.5 week's pay for each full year of service where your age was under 22
- 1 week's pay for each full year of service where your age was 22 or above, but under 41
- 1.5 week's pay for each full year of service where your age was 41 or above.

Your employer may pay more redundancy pay than above as detailed in your contract of employment, however, they cannot write into your employment contract that a lower amount than the statutory minimum will be paid.

Taxation Issues

When in receipt of a redundancy payment it may fall (or parts may fall) into one of the following three categories:

1. Entirely exempt
2. Entirely chargeable or
3. Partially exempt.

1. Entirely exempt payments

For the payment to be entirely exempt from tax it must either be:

1. A payment upon death of the employee (or on account of injury or disability)
2. A lump sum payment from/to a registered pension scheme or
3. Legal costs recovered by the employee from the employer following legal action to recover compensation for loss of employment.



Disclaimer - for information of users - This briefing is published for the information of clients. It provides only an overview of the regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this briefing can be accepted by the authors or the company.

2. Entirely chargeable payments

Any payment not falling within the entirely exempt categories above that is made in return for service, will be fully taxable under the normal employment income rules. Although this can be quite a complex area to identify, in general terms, if the contract of employment provides for the payment to be made then it will be in return for service. If payments are made under 'restrictive covenants' i.e. in return for the employee promising something (normally not to work in a specific area or for a specific competitor) after termination then they are always taxable in full.

3. Partially exempt payments

Other termination or redundancy payments such as compensation for loss of office are not taxable under the normal employment rules as general earnings because they are not in return for services (provided they are paid 'ex-gratia' i.e. not contractually paid). They are, however, taxable as specific employment income with the first £30,000 being tax free.

Any costs incurred by the employer in relation to outplacement services i.e. counselling for the employee's benefit, are exempt and do not reduce the £30,000 exemption.

Please be aware that HMRC may treat termination payments made on or around an employee's retirement as arising from an unregistered pension scheme and, as such, they would be taxable in full with no £30,000 exemption. HMRC indicate that a person of middle age moving on to further full time employment would not be caught by this but a person of older years who has no prospects of further full time employment may be caught.

You should take great care when determining if the redundancy payment is taxable in full or part. It is generally advisable to have all redundancy agreements reviewed by a suitable qualified person (an employment lawyer would probably be best placed to do this) to ensure the correct tax treatment is applied to the payments.


Remember also that these payments will need to be reported on your self assessment tax return for the year in which the payment is due if you need to complete a return for whatever reason. If you are not normally required to complete a self assessment tax return you may have to if there is further tax to pay on the payment.

Director's Redundancy

Director's who are also employees can claim redundancy under the normal rules provided they are working under a contract of employment. However, in the case of *Buchan v Secretary of State for Employment* (1997), where the director was a major (controlling) shareholder, it was ruled that they were able to block their own dismissal and, therefore, cannot be an employee for redundancy purposes. It may also be worth noting that someone who is 'self-employed' may, in fact and in law, be an employee and, if employed for 2 years or more, may also be entitled to a statutory redundancy payment.

To close

Redundancy is a very complex area and failing to follow the correct procedure can prove to be costly, if you are being made redundant or are making an employee redundant you should always seek legal advice.



Disclaimer - for information of users - This briefing is published for the information of clients. It provides only an overview of the regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this briefing can be accepted by the authors or the company.