

UK Universities: A Taxing Situation

More than a third of the elite UK universities were forced to make staff cuts last year.

In Financial Times article dated the 20 January 2025, the above introduction was accompanied by the statement that severance spending across the Russell Group of Universities rose by more than a fifth, the reason being a drop in International students.

It was further reported that ten of the 24 universities in the group ran voluntary severance schemes in 2024. Collectively, the universities in the group spent **£70m on severance pay last academic year.**

This article does not offer any political commentary on this revelation, rather we focus here on the Income tax and National Insurance (NI) treatment of these packages. From experience, these payments are not always treated correctly resulting in HMRC being able to recover Income tax and NI liabilities with penalties and interest also being levied.

So with the sector already reeling from economic pressures, these liabilities could be devastating, coupled with possible reputational damage.

Termination payments are considered by HMRC as one of the main areas of employment taxes risk. This is in part due to the different component elements within any settlement package and how they are treated for Income tax and NI purposes.

The normal contractual payments, such as statutory redundancy pay, holiday pay, unpaid wages and payment in lieu of notice, are subject to Income tax and Class 1 NI as earnings and generally treated correctly by the employer.

However, the following are examples of areas which employers get wrong:

- ◆ Post-employment notice pay (PENP).
- ◆ The on-going provision of benefits after the employment has ceased.
- ◆ NI liabilities on redundancy payments which exceed £30,000.
- ◆ Discrimination claims.
- ◆ Post year end reporting obligations.

We consider below each point briefly.



Common areas of employer error:

PENP

The PENP rules were introduced in April 2018 and although it removed any ambiguity regarding Income tax and NI due on payment in lieu of notice (PILON) payments, it has brought other challenges and now involves a complex formula. Essentially, the idea is to ensure that all unworked notice period is processed via payroll and subject to the appropriate Income tax and NI deductions. If an individual does not work their full notice period, any "relevant termination award" (RTA) will be taxed as general earnings (and therefore subject to Income tax and Class 1 employer's and employee's NI) in so far as it is equal to (or less than) the PENP.

This also means that some termination payments and benefits are chargeable to Income tax and NI and no longer benefit from the £30,000 threshold available under Section 403 Income tax (Earnings and Pensions) Act 2003 (ITEPA). Employers will need to use the formula to check that they are fully compliant, because in certain circumstances – even if the PILON payments have been correctly processed via payroll and appropriate Income tax and NI deducted – there may still be further Income tax and NI liabilities that arise on any additional RTA payments.

Continued benefits

It is common for benefits such as a Company car or medical health provided to employees during their employment to continue for a period post termination. The resulting interactions between the benefits code and Section 401 ITEPA 2003 can be complex, but HMRC guidance states that: *"as a matter of practice benefits that straddle the termination should be apportioned on a time basis, those falling after termination being taxed under Section 401 ITEPA 2003"*.

NI liabilities on redundancy payments which exceed £30,000

The error arises when the 'non-taxable' element (often referred to as ex-gratia payment) is assumed that the first £30,000 of the payment is always Income tax and NI free. The other error is missing the Class 1A NI due on all payments over £30,000. This was introduced from 6 April 2020.

Discrimination claims

Post 2021, compensation payments for discrimination can only fall under Section 401 ITEPA 2003 if they are 'connected' with the termination or with a change in duties of employment. Any settlement agreement must clearly state the connected part and if it does not specify what part of the payment is so 'connected', the facts must be analysed with care and part apportioned, if necessary, on a just and reasonable basis.

HMRC give examples in their Employment Income Manual of payments that are considered connected and those that are not. For instance, a compensation for discrimination representing future loss of earnings (after termination) will be connected with termination, and so Section 401 ITEPA 2003 applies, (even where discrimination led to termination or where termination itself was discriminatory). Compensation for historic loss of earnings (such as in gender discrimination and unequal pay situations) has no connection to the termination of the employment and so the provisions within Section 401 ITEPA 2003 will not apply.

Post year end reporting obligations

It is not necessary to file a report:

- ◆ Whenever a settlement is made wholly in cash, PAYE returns will be filed and there is no need to make any further reports.

or

- ◆ Settlements estimated to be less than £30,000 in total value.

Even if the settlement is wholly cash or its value doesn't exceed £30,000, the ex-employer may need to report it to HMRC in two circumstances.

These are:

- ◆ If a settlement now contains non-cash benefits and exceeds £30,000.
- ◆ Cash and non-cash benefits that were originally under £30,000 are changed to exceed £30,000 in value.

The ex-employer must then notify HMRC (with a copy to the ex-employee) within 92 days of the end of the year in which the change occurred. There is no template for this report, but it must include the information from HMRC's Employment Income Manual (13850).

In some cases, the ex-employer may need to file a further report. It occurs when payments are changed or when other benefits are changed in nature and amount. A material change must be reported to HMRC within 92 days of the end of the tax year in which it occurred. HMRC consider that such a report would be required if the value increased by more than £10,000.

On any HMRC Employer compliance review, the Inspector will always review the termination payments in detail, ensuring each component is treated correctly. It's called 'peeling the wrapper ' and means reviewing all supporting documents such as employment contract, staff handbook, any Settlement Agreement, meeting notes etc.

What should Universities and other higher education establishment do to remain compliant?

- ◆ Keep robust records of everything associated with the termination payments.
- ◆ Breakdown the termination payment, ensuring that each component has been treated correctly.
- ◆ All contractual payments should be processed via payroll and subject to the appropriate Income tax and NI deductions.
- ◆ Any payment for restrictive covenant has to be processed via payroll and subject to the appropriate Income tax and NI deductions.
- ◆ Any payments linked to retirement has to be considered under different legislation and will be liable to Income tax and Class 1 NI.
- ◆ In very special circumstances such as ill-health, injury or disability, the whole amount may be exempt.

How can the Employment taxes team help?

We have a team of employment tax specialists, with considerable experience advising on a wide range of issues, but especially termination payments. The team can help you ensure that any termination payment is/has been treated correctly from the outset helping to ensure the College or University are fully compliant with its reporting and compliance obligations.

Contact Dinesh Pancholi, Employment Tax Senior Manager and let's talk.



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