Article – Redundancy Payments and Reliefs Available to The Individual Taxpayer.

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Redundancy and Termination Payments

We entered 2009 with several warnings ringing in our ears:

1) *"Small Firms Association warn that 14% of companies expect to make staff Redundant in 2009";*
2) *"Economists predict over 100,000 additional redundancies to arise in Ireland during 2009";*
3) *Newspapers warn of "a drop in the standard of living in 2009 due to rising costs and spiraling job losses."*

Within a few short weeks, these predictions were already out of date. The rate of job losses and redundancies continues to proceed at an alarming rate.

Redundancy, whether compulsory or voluntary, will give rise to a lump sum termination payment. Part of this payment will be taxable and part will be exempt. Lump sum termination payments and the exemptions and relief thereon are a very important and topical area. This article will focus on redundancy payments and looks at the elements of relief that are available to the individual taxpayer.

RELIEF:

(i) Relief is available on the amount of the payment that is **exempt** from tax. The calculation of the exempt amount involves the use of three formulae. The highest result obtained is the one that is selected.

(ii)A second measure of relief is available on the amount of **tax charged** on the taxable portion of the termination payment.

RELIEF (i) FORMULAE:

1) Basic Exemption: €10,160 + €765 for each complete year of service
2) Increased Exemption: Basic exemption as above,

PLUS

[€10,000 LESS any tax free lump sum received or receivable from a company pension scheme**]**.

3) SCSB (Standard Capital Superannuation Benefit): $A \times \frac{B}{15} - C$

Where,

A = The average of emoluments, including BIK, for the last three calendar years up to the date of leaving.
B = Complete years of service.
C = Any tax free lump sum received or receivable from a company pension scheme.

ELEMENTS OF A REDUNDANCY PACKAGE:

Payments made to a redundant employee can include:

- Statutory redundancy pay.
- A lump sum payment from an approved pension scheme.
- Ex-gratia payment i.e. payment made at the discretion of employer.
- Retention of a company asset e.g. company car.
- Payment in lieu of notice.
- Holiday pay - **Note**

Note: Holiday pay is a payment in lieu of a holiday entitlement that has not been taken at the time of leaving the employment. It is treated as normal salaried pay and is taxable under Schedule E. The two measures of relief discussed here will not apply to it.

STATUTORY REDUNDANCY

Statutory redundancy is an exempt payment and can be ignored.

Tom Jones was made redundant on 31st December 2008 after 24 ½ years of service. He received statutory redundancy of €12,000…………

Solution

Here, Tom's statutory redundancy payment is ignored and is not taxable.

LUMP SUM PAID FROM AN APPROVED PENSION SCHEME

These payments arise on cessation of the employment whether the redundancy is compulsory or voluntary.

Continuing the example:

…...Tom also received a lump sum payment from the company's pension scheme of €77,500.

His average emoluments for the last three years to the date of leaving were €27,000 ………

Solution:

1) Basic exemption: $\quad$ *€10,160 + (€765 x 24)* $\quad$ = $\quad$ *€28,520*

2) Increased Exemption: $\quad$ *€28,520 +(€10,000 - €0)** $\quad$ = $\quad$ *€38,520*

3) Standard Capital Superannuation Benefit i.e. SCSB:

$$A \times \frac{B}{15} - C: \quad €27,000 \times \frac{24}{15} - 0 = \underline{\underline{€43,200}}$$

**** The additional bracketed amount here will never fall below zero. It will not give a negative result.***

Tax free-lump sum

Continuing Tom Jones example:

…...The present value of the pension lump sum payment that Tom will receive at retirement age is €4,000……

Solution:

The tax-free lump sum payment is not taxed itself but it WILL REDUCE the Increased Exemption and the SCSB as follows:

1) Basic exemption: €10,160 + €765 x 24 = €28,520
2) Increased Exemption: €28,520 +(€10,000 - €4,000)= €34,520
3) SCSB (Standard Capital Superannuation Benefit):

$$A \times \frac{B}{15} - C: \quad €27{,}000 \times \frac{24}{15} - €4{,}000 = €39{,}200$$

SCSB will be chosen as it gives the highest result.

EX-GRATIA PAYMENTS

These payments are usually made in recognition of past performance and include compensation for loss of office. They are treated in the same way as the lump sum payments above.

Continuing example:
……In addition, Tom received an ex-gratia payment of €20,000

Solution:
The basic, increased basic and SCSB calculations above remain unaltered.

RETENTION OF COMPANY CAR

The asset will be included in the final payment at the **current** market value.

Continuing Tom Jones example:
…...Tom retained his company car on leaving. The market value of the car at date of leaving is €9,000.

Solution:
The retention of the asset is taxable but will not affect the exemption amounts already calculated.

PAYMENTS IN LIEU OF NOTICE:

These payments will be

Continuing Tom Jones example:
………Tom only received one week of notice of his employment termination, although he was entitled to one month's notice. He received a payment of €2,500 in lieu of his notice entitlement.

Solution:
These payments are taxable if they exceed the exempt amounts already calculated.

If we compile Tom Jones' total package, Tom received €109,000, ignoring statutory redundancy:

- Statutory redundancy - exempt
- Lump sum payment from the company's pension scheme - €77,500.
- Tom ex-gratia payment - €20,000
- Company car - market value €9,000.
- Payment in lieu of notice - €2,500

The taxable portion of Tom Jones' lump sum is calculated as follows:

Total	€109,000
Exempt	(€ 39,200)
Taxable	**€ 69,800**

RELIEF (ii) – TAX LEVIED

The second relief looks at the **tax levied on the taxable part** of the lump sum - which in Tom's case is €69,800. This tax will be limited to the average rate of tax borne by the individual over the previous three tax years. This rate is either given OR it can be calculated:

$$\frac{\textbf{T}\text{ax on total income in last three tax years}}{\textbf{I}\text{ncome aggregate of last three tax years}} = \text{xx.xx\%}$$

The tax charged on the taxable part of the lump sum under normal rules, is compared against the tax calculated on this taxable portion of the lump sum, by reference to this averaged rate obtained. The difference on comparison is known as Top Slice Relief.

Returning to Tom Jones. Assume the following additional information is given for him:

Year	***Taxable Income***	***BIK***	***Tax***
€	***€***	***€***	***€***
2005	*42,000*	*3,000*	*14,425*
2006	*43,000*	*3,000*	*15,000*
2007	*43,750*	*3,000*	*15,600*

Tom's salary to date of leaving was €44,000. BIK was €3,000. Tom is single and has no other sources of income.

Solution:

Tom's average rate of tax is $\frac{€\ 45{,}025}{€137{,}750} = 32.69\%$

		€
€69,800 @ 41%	=	*28,618.00*
€69,800 @ 32.69%	=	*22,817.62*
Top Slice relief		***5,800.38***

The Top Slice Relief calculation follows on the next page.

The Top Slice relief will be deducted from the final tax liability calculated:

Tom Jones
Income Tax computation
2008

		€
Schedule E – salary		47,000
	Lump sum	69,800
		116,800
Taxed:	€35,400 @ 20%	7,080
	€81,400 @ 41%	33,374
		40,454
Less tax credits:		
	Single	(1,830.00)
	PAYE	(1,830.00)
		36,794.00
	Less top slice relief	**(5,800.38)**
		30,993.62
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