SLAUGHTER AND MAY

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Pensions and Employment: Employment/Employee Benefits Bulletin

Legal and regulatory developments in Employment/Employee Benefits

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Find out more about our pensions and employment practice by clicking here.

For details of our work in the pensions and employment field click here.

For more information, or if you have a query in relation to any of the above items, please contact the person with whom you normally deal at Slaughter and May or Clare Fletcher.
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Save the date

Teleconference on Shared Parental Leave

The right to take shared parental leave will apply to parents of children whose expected week of birth (or adoption) is on or after 5th April 2015. The introduction of shared parental leave is a fundamental change, and will require significant work by employers to ensure that they are prepared in good time.

We will be hosting a teleconference on **Wednesday 12th November at 8:30am**. We will take you through the key elements of the new shared parental leave scheme, and explain what this will mean for your business.

If you would like to dial-in to the teleconference, please make a note of the date and let Helen Mulligan know (by phone on 0207 090 5208, or by email: Helen.Mulligan@slaughterandmay.com). We will circulate more details in due course.

Cases round-up

Clawback of bonus attracted tax relief

An employee whose sign-on bonus was clawed back on his early departure was entitled to tax relief on the repayment. The amount repaid amounted to 'negative taxable earnings', which he could deduct from his taxable earnings in the tax year the repayment occurred (*HMRC v Martin*).

Clawback of bonus: M entered into a new contract with his employer (JLT) under which he received a signing bonus of £250,000 in exchange for committing to work for JLT for at least a further five years. Under the contract M was liable to repay a pro-rata amount of that bonus if he gave notice to terminate his employment in breach of his five year commitment. The signing bonus was paid net of tax and NICs, with M receiving a net amount of £147,500 in the 2005/06 tax year. Subsequently, M did give early notice of termination, and became liable to repay £162,500 to JLT under the contractual formula. He made the repayment in three instalments during the 2006/07 tax year.

No impact on original tax treatment… M sought to correct his 2005/06 tax return by reducing his assessment for that year by the repaid amount of £162,500. This would have meant that M would only have been liable for tax on the amount of the signing bonus which he ultimately retained i.e. £87,500. However, HMRC rejected his claim. The Upper-tier Tax Tribunal (UTT) agreed, finding that the structure of the contract was such that the bonus was properly characterised as earnings at the point of initial payment. The contract was not structured as to give M an accruing right to payment of a bonus; M could not argue that the bonus ceased to be earnings when repaid to JLT on the basis that it had not been earned. His 2005/06 tax return could not therefore be amended.

…but repayment did attract tax relief: The UTT did however uphold M's argument that the liability under his employment contract to repay £162,500 occasioned negative taxable earnings (NTE) of the type contemplated by section 11 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003). The UTT was satisfied that M's repayments to JLT arose directly from his employment and were made for the purposes of the employment. The UTT rejected HMRC's argument that the clawback clause was a liquidated damages provision operating on M's breach of contract (and could not therefore give rise to NTE). Instead, the UTT found that the clause was a straightforward contractual provision restoring to the employer part of what it paid for a commitment that it would not in fact receive in full.

This had the effect that:

(i) M could offset the NTE against his taxable earnings in the 2006/07 tax year (when the repayment occurred), and

(ii) insofar as the NTE exceeded his taxable earnings in that year, the resultant loss could be offset against other income of the period or carried back for one tax year, under section 128 of the Income Tax Act 2007.

Points to consider: The use of clawback arrangements is increasing, particularly for listed companies and financial sector firms. The tax implications of repayment are just one of the factors which will need to be considered when drafting clawback provisions. Therefore, when structuring clawback arrangements it is always worth seeking specialist advice on the most appropriate structure for the particular circumstances.

Payment to retired employee under settlement agreement to compensate for loss of private healthcare was taxable

A payment to a retired employee under a settlement agreement by way of compensation for termination of his membership of the employer's private healthcare scheme was found to be taxable as a benefit from an employer-financed retirement benefits scheme (EFRBS) under section 394 ITEPA 2003 (*Forsyth v HMRC*).

Payment for termination of healthcare: F retired from Nestlé UK Limited (N) in 1995. Following his retirement, F was permitted to continue as a member of N's private healthcare scheme for benefit of himself and his family (in exchange for a contribution for doing so). In October 2009, N offered F the opportunity to leave its healthcare scheme in return for a one off payment of £29,783. F accepted the offer and entered into a settlement agreement to this effect. F's membership of the scheme duly terminated, and he received the payment (after deduction of income tax and NICs).

Capital gain or termination payment? F completed his tax return on the basis that the payment he received from N should be taxed as capital gains split equally between F and his wife. Alternatively, F claimed that the payment should be treated as a payment on termination of employment and therefore only subject to income tax insofar as it exceeded £30,000, under section 403 ITEPA 2003. HMRC rejected F's arguments, maintaining that the full amount of the payment was subject to income tax as it constituted a relevant benefit under an employer-financed retirement benefits scheme (EFRBS) under section 394 ITEPA 2003.

Taxable EFRBS benefit: The First-tier Tax Tribunal (FTT) dismissed F's appeal. It noted that the definition of "scheme" in section 393A(3) includes an "agreement", and that the settlement agreement between F and N was a "scheme" for these purposes. Further, section 393B(1)(c) defines "relevant benefits" to include any lump sum, gratuity or other benefit provided after the retirement of a former employee in connection with past service. The FTT held that this applied to the payment from N to F under the settlement agreement. Further, as the payment was taxable under section 394 ITEPA 2003, it could not be taxable either as capital gains or under section 403 ITEPA 2003. The FTT concluded that the payment to F was properly treated as chargeable to income tax in the year in which it was received.

Beware settlement payments on retirement: This decision demonstrates how widely the EFRBS provisions of section 394 ITEPA 2003 may be applied. The classification of a settlement agreement as an EFRBS is particularly significant, as it confirms that any payment made to a retiring (or retired) employee under such an agreement is at significant risk of being caught by these provisions. The employer in this case took the right approach in deducting tax and NICs under PAYE from the payment.

Unfair dismissal: assessing pension loss

When assessing the pension loss on the unfair dismissal of an employee with a highly specialised role (which made it likely that, but for her dismissal, she would have remained with the employer until retirement), the "substantial loss approach" is more appropriate than the "simplified approach", according to a recent judgment of the Court of Appeal (*Griffin v Plymouth Hospitals NHS Trust*).

Approaches to pension loss: The Employment Tribunal guidance 'Compensation for loss of pension rights' (the Guidance) provides for two approaches to the calculation of pension loss:

- the "simplified approach", which is based on the employer's contributions to the pension fund, on the assumption that those contributions will equate to the value of the pension (attributable to the employer) that would have accrued. The Guidance suggests that the simplified approach will be appropriate in most cases, where an employee would likely have changed jobs and left the scheme before retirement in any event.

- the "substantial loss approach", which uses actuarial tables to assess the capitalised value of the pension rights which would have accrued up to retirement. This will typically result in a much larger award. The Guidance suggests that this approach may be more appropriate in cases where there is a higher chance that, but for the dismissal, the employee would have remained an active member of the scheme until retirement. This would include long-serving employees, where the employment was of a stable nature and unlikely to be affected by the economic cycle, or where the person dismissed has reached an age where they are less likely to be looking for new pastures.

Specialist employee unfairly dismissed: G was employed by the Trust as a specialist clinical technician in bone densitometry. She was a member of P's final salary pension scheme. G became ill in 2007 and was diagnosed as suffering from systemic lupus erythematosus. She resigned in 2009 on the basis that the Trust had made wholly inadequate efforts to enable her to return to work in a way which would accommodate her condition. G successfully claimed constructive unfair dismissal. The Tribunal awarded G compensation using the simplified approach to the assessment of pension loss, which was upheld by the EAT.

Likelihood of remaining until retirement: The Court of Appeal allowed G's appeal. In its judgment, the substantial loss approach was in fact the correct one in this case. The Tribunal had erred in failing to engage with the question of whether G would have been likely to stay with the Trust up to her retirement date. G's relatively youthful age (34, at the time of dismissal) could not be treated, of itself, as decisive of this issue. G's case was that, as an employee with a specialist skill for which the principal (if not the only) market was in the NHS, she was likely to remain in the NHS for the whole of her career, and that she would not, in the language of the Guidance, seek "new pastures". The Court commented that that was all the more so given that G suffered from a medical condition that made her cautious about embarking on major change.

Substantial loss approach was the right one: The Court concluded that, had it directed itself correctly, the only conclusion open to the Tribunal in the particular circumstances of the case was that it should follow the substantial loss approach. The case was remitted to the Tribunal to assess G's pension loss using the substantial loss approach.

Remember the cap: Pension loss is often one of the most significant elements of unfair dismissal compensation, particularly where (as here) the employee was a member of a defined benefit pension scheme. The substantial loss approach also tends to give rise to larger awards. However, any award for pension loss will remain subject to the overall cap on the compensatory award for unfair dismissal, currently set at £76,574 or a year's pay, whichever is the lower.

Points in practice

Employment law proposals at political party conferences

At the Conservative Party's Annual Conference last week, there was mention of a number possible employment law reforms, most of which are already in progress. These included banning exclusivity in zero hours contracts (through the Small Business, Enterprise and Employment Bill), and preventing trafficking of workers (through the Modern Slavery Bill).

The most controversial proposed reform announced however was to limit the status of judgments of the European Court of Human Rights to "advisory only", so that they are no longer binding on British courts. Failing that, the Conservatives have pledged to withdraw from the European Convention on Human Rights and repeal the Human Rights Act 1998, in favour of a new British Bill of Rights.

In Manchester, the Labour Party Annual Conference considered a contrasting raft of employment law proposals, which included increasing the national minimum wage to £8 per hour by 2020; requiring companies with more than 250 employees to publish the average pay of men and women at each pay grade; increasing free childcare for working parents with children aged three or four years old to 25 hours' per week; and an outright ban on the use of zero hours contracts and tax breaks for employers that pay a living wage, as part of a crack down on "rogue employers".

As the 2015 General Election approaches, employment law looks set to play its part in each party's election manifesto.

BIS guidance on prescribed persons for whistleblowing claims

BIS has published new guidance "Blowing the whistle: list of prescribed people and bodies" (October 2014). The guidance essentially reproduces the statutory list of prescribed persons (predominantly regulators) to whom an employee may be able to blow the whistle. The guidance does however re-jig the list so that it is organised by sector.

BIS guidance on calculating the national minimum wage

BIS has published new guidance "Calculating the minimum wage" (October 2014). The guidance provides practical advice and examples to explain:

- what counts and does not count as pay and working hours for minimum wage purposes;
- eligibility for the minimum wage;
- how to calculate the minimum wage; and
- how BIS will enforce the minimum wage.

And finally…

Unlimited holidays, anyone?

Flexible working is nothing new to the UK employment market. It was even given a boost in June this year, when the right to request flexible working was extended to all employees (not just parents and carers).

However, there is a new trend beginning to emerge in a few companies – the concept of unlimited holidays. Netflix, Virgin Group and Mishcon de Reya are just a number of the organisations that have announced plans to allow their employees to take as much holiday as they want; the only proviso being that there must be no adverse effect on their work.

In Virgin's case, there is reportedly no need to ask for approval, nor say when you plan to return. The assumption is, according to Richard Branson, that his employees "*are only going to do it when they feel 100% comfortable that they and their team are up to date on every project and that their absence will not in any way damage the business – or for that matter their careers*".

As attractive as this may seem at first glance, the proposal is fraught with difficulties from an employment law perspective. On the one hand, there may be employees who take significant amounts of holiday, to an extent that the employer finds excessive. How straightforward will it be for employers to police this sort of tactic, and take action against the offending employees, with such a flexible policy?

On the other hand, there may be employees who are reluctant to take any holiday at all, for fear that any absence is bound to have an impact on their work and their career. In these circumstances, employers may struggle to meet their obligations to ensure that employees are being permitted to take at least the 5.6 weeks' minimum holiday required by the Working Time Regulations 1998.

With the exception of Netflix (who have reportedly had the policy since 2010) the initiative is a very new one for the organisations who have adopted it. It remains to be seen how successful it is, and how many other companies follow suit.

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