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# HR News

## Employment



### TAX TREATMENT OF POST-P45 TERMINATION PAYMENTS

As the law currently stands, if an employer makes a termination payment to an employee after the P45 has been issued, and the payment is taxable (in whole or in part), it is required to deduct tax at basic rate only. This can result in a cash flow advantage for higher paid employees, since it is not until well after the end of the tax year that any balance becomes due.

This position is about to change. From 6 April 2011, employers making payments after the P45 has been issued will be required to deduct tax using a new tax code (OT) which gives no personal allowance and requires deductions at basic rate (20%), higher rate (40%) and additional rate (50%). These new arrangements could result in a cash flow disadvantage for employees. They will, however, be able to recover any over-deduction either later in the year via PAYE or under self-assessment.

Employers may wish to consider making any payments before issuing the P45, in which case they will be required to operate the employee's existing tax code, giving credit for personal allowances and taking into account the employee's other income and unused basic rate band, etc. But again, because of the way tax codes work, this could result in a cash flow disadvantage for employees if the dismissal takes place at the beginning of the tax year.

From an employer's perspective, it does not matter whether payments are made before or after issue of the P45, as long as it deducts the correct amount of tax. These changes do, however, mean that the post-P45 route no longer offers the cash flow advantages and negotiating opportunity it used to. It also means that employers making termination payments may face requests from employees to make payments either before or after the P45 is issued, depending on which date is most advantageous for their own cash flow purposes. It will not be up to employers to spend the time and effort necessary to work out the best position for the individual employee.

If you would like any further information about anything set out in this Alert please contact the following or your normal Squire Sanders Hammonds' contact:

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