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The Taxation of Employment Law Awards and Settlements

Paper presented to the Adjudicators Course run by the Department of Jobs, Enterprise and Innovation

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These notes are intended to do no more than refresh the memories of those attending this seminar. Whilst every care has been taken in preparing these notes to ensure their accuracy they cannot be exhaustive and are no substitute for a detailed examination of the relevant Statutes, cases and other materials. No responsibility can be accepted by the speaker for any loss sustained or occasioned to any person acting or refraining from acting in reliance on anything contained in these notes. No part of these notes may be reproduced in any form without the prior permission Richard Grogan.

The Taxation of Employment Law Awards and Settlements

The talk today intends to deal with the taxation aspect of employment law awards, settlements and termination payments as it affects Adjudicators.

This paper will deal with the taxation of employment law awards and settlements. Unlike other areas of law there is no "equity" in tax. Tax follows the law or more precisely how a decision is written. Write it one way and it is tax free. Write it another way and it is taxable. That may not seem fair but as I said "there is no equity in tax". Something is taxable or not taxable. There is no half way or middle ground. Therefore as Adjudicators you have a huge responsibility to get it right. Get it wrong and you either cost the State lost revenue or you put unnecessary tax on both the employer and the employee.

In presenting this paper I am conscious of the fact that often when the word "Tax" arises in employment law matters whether it be an award, settlement or a termination payment there is a tendency especially for Lawyers to believe that this all revolves around numbers, calculations and that it is something which is alien to Lawyers, employer and employee representatives and is a specialist area for Accountants. Hopefully this paper will show that the taxation treatment of termination payments, employment law awards and settlements is the application of relatively simple rules.

For those who represent employers I sometimes come across the view expressed that the employer is going to tax the award and it is a matter for the employee to make a reclaim.

At the outset I would say that it is as important for an employer to be able to avail of the tax exemptions as it is for an employee. If an award, settlement or termination payment is subject to tax the employer has employers PRSI to pay which is an additional amount of money which is payable by the employer. Where the income of the employee is over €356.01 per week the employers PRSI is 10.75% and below this figure it is 8.5%. Therefore the difference on what an employer has to pay if for example an award is for €15000 which is exempt from tax as opposed to an award which is subject to tax is €1612.50 as an additional cost to the employer.

If the tax treatment is done incorrectly by the employer and is taxed the employee may still be able to make a reclaim of all the tax but the employer would still have liability for the PRSI as the employer will have categorised it as a taxable amount. In addition the employee will be subject to an implementation claim. An incorrect payment to the Revenue does not avoid such a case arising.

The Relevant Tax Legislation

The starting point in relation to an understanding of the tax treatment of employment law awards and settlements is the relevant legislation.

Section 192 (A) TCA97 was inserted by Section 7 FA2004. As amended by Section 5FB 2015 this Section was inserted because of the fact that the Revenue in 2003 sought to tax all employment law awards and settlements. A subcommittee of the Taxation Committee of the Law Society (now the Taxation and Probate Committee) met with the Department of Finance. As a result of those negotiations the legislation was implemented and can be simply understood as follows.

If the award relates to a loss of wages such as an Unfair Dismissal claim or a Payment of Wages claim it is taxable

If the award of settlement relates to compensation for breach of a statutory entitlement, which is not wages, it is exempt.

The fact that an award may look like it is an award of wages does not make it taxable. I think it is useful at this stage to give an example.

If an Adjudicator gives an award of 10 weeks wages for breach of Section 11 Organisation of Working Time Act (OWTA) which is a breach of the provision relating to the employee getting an 11 hour break that is exempt from tax as it relates to compensation for the infringement of an employment right.

If the Adjudicator awards 10 weeks wages for an Unfair Dismissal claim that is a payment of a financial loss and is taxable.

Understanding the Legislation

The provisions of Section 192 A TCA97 provides that, with effect from 4th February 2004, compensation awards paid following a formal hearing by a "relevant authority" or a settlement (in certain circumstances) in respect of the infringement of an employee's rights and entitlements under the law are exempt from Income Tax. The exemption does not apply, however, to payments which are in respect of earnings, changes in function or procedures of an employment or the termination of an employment. Saying this, there are exemptions in relation to.

While the commentaries on this piece of legislation seem clear their application in practice is often misunderstood. This misunderstanding is not limited to Solicitors and Barristers. Accountants, in particular staff of Liquidators and Receivers, and even some "Tax Advisors" fail to comprehend the practical effect of the legislation.

Those seeking rulings from the Revenue often ask the "question" the wrong way and therefore an "incorrect" answer is received from the Revenue.

The legislation itself is reasonably simple. It is its application in practice which some confuse.

The Legislation

Section 192 A TCA97 can be summarised as follows;

1. An award or settlement for the breach of an employment right of an employee or former employee is exempt from tax, provided;

A It is not a payment in respect of remuneration or arrears of remuneration and

B It is not a payment for a change in function or a termination payment.

However, a termination payment may itself be exempt by Section 201 TCA 97. This I will deal with later.

The Scope of the Legislation

The legislation refers to "a Relevant Act". This is an enactment which contains provisions for the protection of employees' rights and entitlements or for the obligation of employers towards their employees. In practice this means any piece of employment legislation. It will include legislation post 2004. Therefore it would include the Protection of Employees (Temporary Agency Work Act) 2012. The exemption applies for payment under a Relevant Act to an employee or former employee by an employer or former employer after 4th February 2004 in accordance with;

A	A Recommendation
B	Decision; or
C	Determination by a Relevant Authority

A	"Relevant Authority" is defined as

A	A Rights Commissioner,
B	The Director of Equality, The Equality Tribunal,
B(a)	An Adjudication Officer of the Workplace Relations Commission
B(b)	The Workplace Relations Commission
B(c)	The District Court
C	The Employment Appeals Tribunal,
D	The Labour Court,
E	The Circuit Court, or
F	The High Court.

(The Legislation was amended by the insertion of (BA), (BC) and (BD) by the Finance Bill 2015.

The exemptions will also apply to a settlement under a mediation process provided for in a Relevant Act and shall be treated as if made in accordance with a Recommendation, Decision or Determination under the Act of a Relevant Authority subject to certain conditions.

Currently the only "mediation process" provided for under Legislation was Section 78 Employment Equality Acts. The Workplace Relations Customer Service "mediation" process is now provided for under a "Relevant Act". Therefore such mediation agreements do have the benefit of Section 192 A TCA 97 as amended.

Structuring Settlement Agreements to be Exempt from Tax

The provisions of Section 192A TCA97 also apply to out of Court Settlements. Therefore the agreement under the WRCS could qualify. However to qualify certain conditions must be met namely;

1. That it is a bona Fide claim made under the provisions of a relevant Act,
2. Which is evidenced in writing, and
3. Which had the claim not been settled by agreement, is likely to have been the subject of a Recommendation, Decision or Determination under that Act by a Relevant Authority that a payment be made. (underlining added).

All conditions are met by the WRCS mediation. The one that does not is the condition that the agreement certifies that had not the agreement been made it would have been the subject of a Recommendation, Decision or Determination. This condition is set out in Section 192 A (4) (a) (i) (iii). This is the one condition that Solicitors for employers, for some reason have the greatest resistance to incorporate into any agreement. It is however a condition precedent to obtain the exemption. If however such a provision is incorporated into any such agreement / settlement/WRCS Mediation Agreement the exemption will apply.

The form of words which is sufficient for including in this settlement agreement is as follows.

"the employer and the employee agree that the sum of €xxx is a fair and reasonable settlement sum and that such a sum is likely to have been awarded by an Adjudicator / Labour Court in any claim".

The above provision requires to insert the an Adjudicator or the Labour Court. This clause is the one clause that causes the greatest difficulty for employers. There is a preconceived view that any settlement agreement must have the words it is made "Without Prejudice" and without an admission of liability.

If such a clause is not included the settlement agreement does not gain the benefit of Section 192 A. If it is included then it does have the benefit of Section 192A.

Where a settlement document is entered into there is an obligation on the employer to maintain same for a period of 6 years. Section 192 A (4) (a) (iii) provides that copies must be retained for the period of 6 years.

Sub Section (4) (b) provides that copies of these documents can be requested by the Revenue Commissioners.

I do appreciate that some employers and practitioners have a real difficulty with this condition.

It is not that the settlement would not have been one which would likely have been made by for example an Adjudicator but the fact of any admission. The word used is "likely" not "certainly" or any similar word.

There is nothing to stop parties including in a settlement agreement the following.

"It is agreed between the parties that the settlement herein relates solely to case reference xxx and may not be used by either party for the purposes of grounding or defending any other claim under any other Act or at Common Law or otherwise and may not be produced in any other Court, Tribunal or otherwise for the purposes of grounding, supporting, defending or otherwise dealing with any claim by either party against the other party under any other piece of legislation or at Common Law or otherwise whatsoever".

I would say in passing that there is nothing to stop a party settling a matter under for example the Organisation of Working Time Act and then including clause that it resolves all matters between the parties and setting out all the relevant Acts. This is a standard procedure by many Solicitors.

I would be of the view that it is better in those circumstances to provide as follows;

"it is agreed between the parties that the settlement under reference xxx shall be deemed to be in full and final settlement of all claims which the employee may have against the employer and that the employee undertakes not to bring any further claims and to withdraw any other claims already in existence under any of the following pieces of legislation. (And then insert the normal list)".

I have attached a copy of the Finance Act 2004 to this paper. When a settlement is being entered into it is imperative for the purposes of obtaining the tax relief that the relevant provision is inserted to avail of the exemption under Section 192 A.

When a settlement will not be exempt from tax but a Decision, Determination or Recommendation would be.

Section 10 TCA 97 defines connected person

A connected person is "connected with the other person if they are a Husband, Wife or Civil Partner or is a relative or the Husband, Wife, Civil Partner of a relative of the individual or of the individual's Husband, Wife or Civil Partner".

This looks like a bit of a mouthful.

This is additionally so when a relative means a Brother, Sister, Ancestor or Lineal Descendant. This is different than the exception in say the National Minimum Wages Act Section 5. It may be useful to give an example.

Let us assume that employee A in the previous example is a Sister in Law of the employer and employee B is a Brother in Law of the employer. Neither Act referred to previously excludes the employees claiming.

Where employee A has a decision from a Rights Commissioner and employee B has a settlement only.

Even if the settlement with employee B includes the three conditions for the exemption to apply, as set out above, the exemption in the case of a settlement or mediation by virtue of Section 192 (A) (4) (i) is excluded from the exemption. This is because of the fact that employee B is a "connected person". Employee A can receive the Decision exempt from Tax as she will not be relying on the provisions of Section 192 A (4).

Therefore if you are acting in the case of a relative of an employer it is important for Representatives that they proceed the full way for a hearing and get a Determination, Decision or an Order. The provisions of Section 192 A (4) (i) specifically excludes "connected persons".

Mediation agreement by the Equality Tribunal currently would however be exempt under Section 192 A (3). The restrictions only apply to an out of Court settlement not under a mediation process provided for under a Relevant Act. Going forward Equality cases can be settled but not others when the law is changed.

The Tax treatment of Decisions, Determinations, and Recommendations.

The basic distinction between an award or settlement which is exempt and one which is not exempt is a distinction between salary / wages and compensation.

This is the concept which is often misunderstood. The misunderstanding is understandable as employment legislation before an Adjudicator and the Labour Court is denominated as regards compensation on the basis of weeks of wages.

The Maternity Protection Act in Section 32 refers to up to 20 weeks wages. The Unfair Dismissal Act ("UDA") is up to 104 weeks wages. The OWTA is the same. The first and third Acts are gross wages. The UDA is net wages. Decisions may say in a Terms of Employment (Information) Act case that one week or two weeks wages being €x is awarded as compensation.

It is still compensation for infringement of a right rather than the reimbursement of salary or wages. The difficulty can be caused not by the legislation but rather by the application of Employment Legislation by Rights Commissioners, the EAT and the Labour Court with regards to Section 192 A TCA97 currently. I purposely do not include the Equality Tribunal as they, to be fair to them, invariably set out the tax treatment of their awards, currently.

The Equality Tribunal, if the award is compensation for the infringement of a right, will specify that it is exempt from tax. If it is for example an equal pay claim they will specify that it is subject to tax. They have the advantage of limited legislation unlike the other bodies to be fair to the others.

It is useful at this stage to give possible examples of how difficulties can arise with Decisions.

Let us for example take the following case.

Example

Employee C brings a claim to an Adjudicator under the Organisation of Working Time Act. The claims are under Sections 15 for working excessive hours and in relation to not being paid Public Holidays and Annual Leave. Let us assume that the employee earns €400 a week for a 5 day week. There is one Public Holiday that is not paid with a value of €80 as unpaid wages for that date and one week's Annual Leave not paid with an economic value of €400. The Adjudicator declares;

"I find that the complaint is well founded in relation to working excessive hours contrary to Section 15, Public Holidays and Annual Leave. I award the complainant €10,000 as compensation".

In such cases because the award under three Section were all dealt with as a global figure the entire determination is subject to tax. This means that the employer pays the €10,000 to the employee less tax submitted to the Revenue and PRSI and USC to Social Welfare. The employer is also responsible for €1075 employers PRSI. The employer must submit and amended P45. The employee then reclaims the tax. The employer has paid an additional €1075. Let us assume that the Adjudicator deals with the Decision as follows.

The Adjudicators Decision states;

"I declare that the complaints under three Section of the Act in relation to working in excess of 48 hours, public holidays and annual leave entitlements is well founded and is upheld.

I award the sum of €8000 for breach of Section 15.

I award the employee €80 for non-payment of public holidays, €400 for non-payment of annual leave and a sum of €1520 for the infringement of the employees' rights under the Act".

In the alternative as has been set out in the past, it could be provided as follows;

"Redress

Having regard to all the circumstances of this case I award the employee compensation in the sum of €10,000 for the contraventions of the Act which I have found to have occurred. Of this amount €480 is in respect of annual leave and public holiday entitlements. The remaining €9520 is in the nature of a general compensatory amount".

In the first circumstance as set out the entire award as previously stated is subject to tax. In the two latter examples the sum of €480 only is subject to tax with the balance being exempt.

The reason for same is that the Decision clearly sets out that the compensation is compensation for an infringement of a right.

It would be beneficial if the decision added on the words

"In respect of the award of €9520 same is exempt from tax by virtue of the provisions of Section 192 A Taxes Consolidation Act 1997 as it is compensation for infringement of an entitlement under the Act".

You may say that it is the same amount being awarded. You are correct in saying that but it is the words that are used in the Decision determine the tax treatment.

Legislation is clear in that any award is subject to tax if it is a payment, however described in respect of remuneration including arrears of remuneration.

In the first example set out above the award of €10,000 includes arrears of wages. It includes remuneration and is therefore subject to tax.

If the employee has ceased employment then S. 201 TCA 97 applies and the employee can claim a refund of tax on the €10,000 or €480.

How the tax treatment of a particular matter may ultimately be dealt with depends on the wording of the Decision. If I can give you one example where the Decision of an Adjudicator would be subject to tax and the Decision of the Labour Court would be exempt from tax and while I am not giving the parties names I am setting out the wording of the Decision.

Before the Rights Commissioner The Rights Commissioner held;

"There were X public holidays during this reference period. The shortfall is 39 hours multiplied Y per hour equals Z. There were X annual leave entitlements during this reference period. The shortfall is 78 hours multiplied by Y per hour equals Z.

I order the employer to pay to the claimant compensation in the sum of Z + Z for breaches of Section 21 (1) and 19 (1) of the Act".

The matter was appealed to the Labour Court

The Determination of the Labour Court was as follows;

"The complaint is well founded. The Court awards the complainant the sum of "A" compensation for the infringement of his entitlements under the Act".

The total sum was minimal. However that is not relevant.

The issue is what is the tax treatment?

Clearly the decision of the Rights Commissioner was taxable as it is arrears of remuneration.

The Decision of the Labour Court was not taxable as the Labour Court provided compensation for the infringement of the entitlement. However a Revenue official might argue as the case involved "arrears" the decision could be deemed to include arrears and is taxable. The value would be preclude any real challenge to a Revenue ruling.

In another case the tax treatment of an award by the Labour Court could not have been clearer or more precise.

"Having regard to all the circumstances of this case the Court awards the claimant compensation in the amount of €5000 for the contraventions of the Act which it has found to have occurred. Of this amount €2000 is in respect of arrears of holiday and cessor pay. The remaining €3000 is in the nature of a general compensatory amount".

The case reference is DWT1223.
The €3000 is exempt under S. 192A. The €2000 is subject to tax but as it is "cessor" pay arising on cessation of employment relief under Section 201 is available. Therefore no tax is payable.
That Decision could not have been clearer for the tax treatment. Because the decision stated "cessor pay" S. 201 is available. Even if it had not it would on the facts of the decision been available but by putting it in the redress section of the decision the tax treatment is clearly and precisely stated.

It is much more beneficial if any amount of remuneration including arrears, holiday pay or public holiday pay or any matter which was in the form of compensation for an economic loss that is quantifiable in euros and cent is separately provided for with any general compensation being separately specified.

At a minimum it would be far more beneficial if Decisions did specify at least claims on a section by section basis. Therefore the tax treatment would be absolutely clear as regards exempt awards. Therefore if say arrears of wages and compensation are lumped together only part of an award would be taxable and an exempt award for another section would be exempt.

Payments not covered by the exemption.

I have set out in the schedule 7.1.27 of the Revenue Tax Manual and the Revenue notice for guidance.

Payments not covered can be summarised as follows.

1. Actual remuneration of arrears of remuneration.

   This would include a claim for wages under the Payment of Wages Act or an award under the Unfair Dismissal Acts. It would include claims under the Industrial Relations Act and Equal Pay claims under the Employment Equality Acts. It would include a claim for Annual Leave pay or Public Holiday pay under the Organisation of Working Time Act, i.e. actual loss.

   It does not include as remuneration or arrears of remuneration an award under the Terms of Employment (Information) Act even if it specifies that it is four weeks wages or a Decision under the Maternity Protection Act awarding an employee 20 weeks wages or an award for infringement of say the OWTA as regards Annual Leave entitlements as opposed to holiday pay. The fact that the compensation is denominated in weeks of wages does not make it taxable.

2. Compensation for a reduction of future remuneration arising from a reorganisation, a change in working procedures will be subject to tax subject to the relief under Section 480 TCA97.

   Section 480 TCA 1997 refers to lump sum payments made to an employee as compensation for a change in working conditions. This applies to any payment chargeable to tax under Schedule E (e.g. PAYE) made to an employee to compensate the employee for;

(a) A reduction or possible reduction of future remuneration arising from a reorganisation of the employers business e.g. a loss of promotional prospects, with attendant loss of possible higher earnings,

(b) A change in working procedures or working method. Examples might be the introduction of new technology or agreed changes in working methods

(c) A change in duties e.g. a machinist agreeing to load raw material or pack the finished product.

(d) A change in the rate or remuneration e.g. the introduction of a higher basic salary and substitution for a basic salary or commission or the cessation of overtime at a higher rate of pay

(e) A transfer of the employer's place of employment from one location to another.

Payments excluded from the relief are lump sum payments made to directors and employees with proprietary interests or part time directors and part time employees. The relief is claimed after the tax year ends. The relief is such as to reduce the total income for the year or assessment to

(a) The income tax which would have been payable by the employee if he / she had not received the lump sum, plus

(b) Tax on the whole of the lump sum computed at a special rate (an effective rate on the payment of 1/3 only of the lump sum paid).

You require to make a written claim and evidence that any of the items have happened must be furnished for example a statement from the employee.

The timing of payments can be significant.

Example

Let us assume you have an employee earning €15 an hour. You agree to a reduction to €12 an hour. The loss for a 40 hour week is €6340 per annum. The employer agrees to pay €7,540 for this change in work practices on the 1st December 2013 effective as of 31 December 2013. The payment is made on 31st December 2013. The tax treatment is €2513 subject to tax being 1/3 of €7540.

If the payment is made on 1st January 2014 the employee's salary will have reduced by €6340. So there will be no relief on the €6340. Only €1200 will be available to get tax relief on. The employee will pay tax on €400. They will however pay full tax on the sum of €6340.

As such structures are put in place to negotiate with employees very often in effect you are dealing with what they are going to receive net into their hand. There is a significant net difference by paying it on 31st December as opposed to 1st January.

Wages and Arrears of Wages

Claims under the Payment of Wages Act for non-payment of wages are clearly arrears of remuneration.

A claim under Section 18 of the Organisation of Working Time Act where the employee can claim that they were available to work but were not paid where the award would be 25% of the amount which they would otherwise have received is clearly wages and is taxable. Compensation in addition to this for breach of the Act is not wages and is not taxable.

Awards under the Unfair Dismissal Legislation are wages. The reason for this is the terminology of the legislation itself. The maximum award which can be awarded under the Unfair Dismissals Acts is 104 weeks loss. The legislation refers to loss. Therefore the tax treatment follows the legislation.

There are a number of confusing aspects on this. Under Payment of Wages Legislation and the Unfair Dismissal legislation. The awards are "net" wages. In respect of a claim under Section 18 of the Organisation of Working Time Act it would be the gross amount. In addition under Section 18 of the Organisation of Working Time Act an Adjudicator or the Labour Court could award up to two years wages as compensation and the tax treatment will depend on the wording used by the Adjudicator or Labour Court. In respect of the Payment of Wages or Unfair Dismissal Act claim it will always be net wages. This does not mean however that all wages are taxable. This may appear a contradiction.

Example

Employee D has one year service. He is dismissed. He was not paid his last 3 weeks wages. He was not given Minimum Notice. His gross wages was €500 per week. His net was €400.

The Adjudicator awards €1200 under the Payment of Wages Act for Unpaid Wages and €500 for Minimum Notice (Minimum Notice in Gross). In addition a sum of €5000 is awarded under the Unfair Dismissal Acts.

On appeal the Decision is upheld by the EAT. At first sight all awards are "wages" and are taxable. This seems logical. However this is not the position. Section 201 TCA 97 will exempt the Unfair Dismissal Act award as it is less than €10,160. The Minimum Notice Payment will also be exempt. The reason for this is that it is a termination payment. The wages of €1200 is taxable and subject to employers PRSI. It is not a termination payment so S. 201 does not apply.

A claim for wages or a claim for breach of contract for non-payment of wages in the Circuit Court or High Court will always be taxable. A payment which is a termination payment will get the benefit of section 201 TCA 97 subject to the threshold. The threshold amount is €10,160. There is also an additional sum of €765 for each complete year of service in the employment in respect of which the payment is made. It is complete years. Therefore if an employee has 1 year and 11 months service they will get the additional €765. If they have 2 years and 1 month they get an additional €1530.

While it is not strictly speaking part of the seminar the issue which has never really been determined by anybody is what are "net wages".

Example

Let us assume there are two employees who are higher level employees. They are employed for one year. The base exemption applies. They are paid €200k per annum gross. The net for employee A is €150k per annum and for employee B €130k. Employee A maximises every relief that she can under the Taxes Acts while employee B does not.

Nobody has ever described how "net" is arrived at. Whether it is actual or notional.

Saying this, let us assume the Adjudicator awards each 1 years net wages.

Employee A receives €150k. Employee B receives €130K. This is their "net" loss. However, both awards will be subject to tax. Employee A is taxed on €150,000 less €10,925.. Employee B is taxed 130K less €10,925.

As the "employee" will have no tax credits for their tax will be deducted at 40% plus 8% USC (as over €70,044) would be an effective rate of 48% on the Net award. The employer will pay 10.75 for employee A and for employee B but on different amounts as employees PRSI.

The two employees could seek a refund of the tax or they may be able to avail of the other exemptions.

It does however seem unfair to one employee who had put in place for example VHI, put in place permanent health insurance, may have invested in a home and being able to obtain mortgage relief and may have purchased a bike to cycle to and from work where tax relief would have been available that that employee would be deemed to have a higher net than an employee who just took the money at the end of the month and made no provision for their future. I am simply raising it that there would appear to be an argument under the legislation that net wages would be a notional rather than an actual net being calculated on the basis of the tax treatment of the individual as if they were an individual simply claiming the basic allowances. In the example above there would a significant difference between two

employees if one is married and has a working spouse and the other Single that is an issue which is going to have to be determined at some stage.

Conclusion of the Tax Treatment

There is an old adage in taxation that;

"Taxation follows the law".

By this I mean that the tax code will apply to a payment to an individual depending on how it is categorised under the law.

Again, I think it might be useful to give an example.

Let us assume there are two employers.

Both employers sell their business. The business transfers under the Transfer of Undertaking Regulations

Employer A writes to an employee as follows.

"Now that your employment has transferred under the Transfer of Undertaking Regulations to the new employer I would like to thank you for all your work over the years and now that you are finished working for me I would like to make a gift to you of €3000 in appreciation of your work and to thank you for your assistance in the transfer of the business over to your new employer".

The second employer sends the following letter;

"I would like to make you a gift of €3000"

The first payment is subject to tax as it relates to a change in conditions.

The second payment is a gift and it's completely exempt under the Capital Acquisitions Act. this is not an Act you could deal with but it shows there is no equity in tax.

Both employers may have intended to make a gift simplicitor. The nuances of words will determine the tax treatment.

I give the above as a simple example of how the categorisation of matters will determine the tax treatment. If there is a settlement that is put in place under the Payment of Wages Act, The Organisation of Working Time Act, the Maternity Protection Act, the Employment Equality Acts and the National Minimum Wage Act and a global figure is inserted in the settlement agreement the entire will be subject to tax.

If it is split up between the various Acts only the Payment of Wages and the National Minimum Wage Act settlement elements only will be subject to Tax.

For employees it is important so as to maximise the amount of money that they receive now.

For employers it is equally important so as to minimise an unnecessary cost of 10.75% PRSI charge. Where there is no liability to pay it but incorrect structuring of a settlement could cause it to be payable.

When considering a settlement you must always consider Section 201 in respect of any payment which is subject to tax.

If the exemption applies then the employee receives the award without tax and PRSI having been charged. The employer avoids unnecessary cost of 10.75% PRSI charge.

If you have a claim under all of the above Acts this is not a reason for lumping everything under one of the exemption sections. For example the Employment Equality Legislation of the Organisation of Working Time Act.

A settlement must be "bona fide".

It is certainly useful for a representative of an employer particularly to set out the rationale as to why a particular settlement might have been put in place.

For example. You could have a situation of a claim under the Organisation of Working Time Act. If you are acting for a large employer it may well be that a defence which would be acceptable for the owner of a small corner shop might not suffice for a claim by a

significant employer and the level of compensation might well be different. It is therefore useful to specify why a particular award was recommended to an employer. When considering settlement it is a settlement or an employment law award it is imperative to, look at section 192 A TCA 97 firstly to see if it is exempt. It is then necessary to look at the other exemptions such as section 201 as a fall-back position. Section 192 A TCA97 is not a catch all solution to pay tax free by lumping everything under an "Exempt Act".

The Tax Treatment of Legal Fees

It is always nice to finish with something which is close to the heart of all lawyers. That is the tax treatment of their fees.

Legal fees paid in employment cases provided they are reasonable are exempt from tax in calculation the tax in settlement or award.

Let us assume for example there is a case under the Unfair Dismissal Acts. The employee has worked for the employer for 10 years. They are therefore entitled to the exemption of €765 for each complete year of service being €7650 together with the section 201 exemption of €10160. This amounts to €17810. The claim settles for €25000. The settlement document specifies as follows.

"The employer shall pay the employee the sum of €25000 as to €18850 to the employee and a sum of €6150 (inclusive of VAT) being legal fees to X solicitors".

As the exemption of Section 1912 A does not apply it is not necessary to specify this.

The exemption under Section 201 together with the additional €765 per annum gives the employee the sum of €17,810 exempt from tax.

The €6150 inclusive of VAT payable to the Solicitors is exempt in the calculation of tax. The only sum subject to tax is €1040.

If the settlement had simply been;

"The employer shall pay to the employee the sum of €25000".

Then the position would be that even if the employee has agreed to pay their Solicitor the sum of €6150 the sum of €7190 would be subject to tax. The employer pays full PRSI.

It is therefore beneficial to both employers and employees in the above example to split the settlement as to what shall be paid to the employee and what should be paid to their legal representatives.

If this had been a decision by an Adudicator, then the sum of €7190 is taxable. Both the employer and the employee have a liability.

It therefore makes economic sense for both representatives of employers and employees who are putting in place settlement agreements to specify what the legal fees will be. It also makes sense to settle. In the above example it would be better for the employee, financially, to settle for €23,000 as to €17,000 to the employee and €6000 to their Solicitor than receive an award of €25,000.

Overall conclusion

I do hope that this seminar will be of some practicable benefit to you. We are told that as part of the new scheme being introduced by the Minister in relation to employment law that standard format decisions will issue.

I do hope that the Minister will consider in any new legislation including in particular a mediation provision similar to the Employment Equality Acts to cover all the other pieces of legislation so that the mediation service will be tax efficient and have the same status as the Equality Tribunal mediations.

Whether it is Adjudicators or the Labour Court giving Decisions it makes sense that the decision will specify what portion of any Decision or Award is taxable or whether the whole of the compensation is taxable or the whole is not taxable.

It makes sense that both the Labour Court and Adjudicators going forward will have access to specialist taxation advice on the structuring of Decisions so as to be in conformity with the legislation.

It does not make sense for either an employer or an employee that an award which might include say 10% of it being arrears of wages will be subject to tax in its entirety which is an unnecessary cost for an

employer. Equally, it would be wrong if an award was in the format of an economic loss being structured in such a way because of the wording of the decision that it got the benefit of Section 192 A TCA 97.

The simple solution would appear to be that a person from the Revenue would be seconded to the new service that would be in a position to give appropriate advice. This I would have a concern about. It would be necessary to have an individual who is both conversant with tax and conversant with employment law, Saying this, it would probably be sufficient if an Adjudicator or Labour Court wished to obtain advice that there would be a nominated person from the Revenue seconded to the new service where for example an Adjudicator could state I am finding that there was an entitlement under the OWTA and Payment of Wages Act. I propose to award the economic loss of €X. I propose to make an award of €Y as general compensation being a total of €Z and how is that to be structured in an award so that the sum of €Y will be treated as compensation.

There is a significant reason for this. The Equality Tribunal to date has been absolutely precise in the tax treatment of their awards. There can be no misunderstanding. Representatives of both employers and employees are very clear as to what the award says. The tax treatment is clear. This also applies to Tax Advisors, Accountants or the Revenue where a determination is sought. The wording of the Decision determines the treatment and in particular the Decision specifies whether the payment is compensation and therefore exempt or not. There should be no cost other than confirming what is written in black and white.

I am not criticising the Employment Appeals Tribunal, the Rights Commissioner Service or the Labour Court in the formatting of their Decisions. None of them are expected to be Tax Specialists nor to be involved in structuring decisions to be tax efficient. They have a different role. The requirement of taxation knowledge as regards structuring Decisions should not be a requirement for them. Their role is far more important than the tax treatment. Therefore the tax treatment should have the input of specialists to ensure the rationale of decisions accords with the tax treatment. An exempt award should not become taxable because of the “wording” used nor visa versa. Saying this however, the tax treatment of any Decision from these bodies will depending on the wording used which determine the tax treatment.

The rational for this is very clear. The Minister has said that he wished to reduce the economic regulatory and costs to employers. The cost of obtaining tax advice, the cost of unnecessary PRSI because of the wording of a decision is an additional cost to an employer over and above the cost of paying out on any award. The additional professional fees payable are a real cost. The economic cost to the employer can be minimised by reducing the professional fees which need to be paid. It brings certainty to the employer's tax situation. It means that they do not have the difficulties in relation to future Revenue Audits. It reduces costs. The same applies to the proper structuring of Mediation Agreements. What is properly taxable should be taxed. What is properly exempt should be exempt. My proposal for seconded Revenue officials would be cost neutral. The Revenue would know what they should receive tax on. The employer would know what they have to pay tax on. The employee sees what is taxable.

This is not some form of tax avoidance scheme. It is simply structuring matters correctly in accordance with the Decisions so that the correct amount of tax is charged.

When I was being trained in what was the Pricewaterhouse "way" (and Now PricewaterhouseCoopers) on tax I was trained by an ex Inspector of Taxes. He specified that in his view there were only two sins. I don't believe that he had read the Ten Commandments. The two sins which he specified were;

a. Paying less tax than you are obliged to pay; and

b. The greatest of all the sins – paying too much tax.

I believe that he could have added a third one which is

a. Having to pay for tax advice where a Decision could have specified which elements were taxable and which elements were not taxable.

I many years ago wrote a book entitled "Payroll and Taxation for Employers" with Ken O'Brien of PwC.

If I remember correctly our working title on it was "The Complete Cure for Insomnia".

I hope that we do not send you to sleep this afternoon and equally I hope that I have explained matters in a simple way.

The legislation is not that complex. It is its application where matters proceed without reference to the legislation which causes the problems. Tax follows the law. It is not something to be scared of. The exemption in the legislation is there to be claimed. It is not a tax avoidance scheme. It is an exemption specifically introduced by the Minister for Finance because of an anomaly in the tax legislation. It is no different that claiming the VHI premium against your tax or your pension contribution. If an exemption is there it should be claimed. It should be recognised and it should be applied.

It benefits both employers and employee.

It results in both paying the tax which they are obliged to pay and nothing more or less.

I would like to thank you for your attention today and wish you well in structuring your Decisions going forward in applying the proper tax treatments to Decisions.

Richard Grogan
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