How is a redundancy payment taxed?

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Following on from my previous blog based around redundancy and whether retiring was viable, one of the first questions people ask is 'is my redundancy pay taxable?'. A redundancy payment can be made up of many elements and each will either be tax-free or taxable.

So, what is tax-free?

Quite simply, up to £30,000 of redundancy pay is tax-free.

Additionally, if you are given non-cash benefits as part of your redundancy package, such as keeping the company car or laptop, these items would be given a cash value and added to your redundancy pay. This is something to be wary of as it may push you over the £30,000 limit.

And what parts are taxable?

Firstly, any redundancy pay over £30,000 is taxable. Other elements which make up your overall redundancy package are taxable. This could include any of the following:

- Pay in lieu of notice
- Holiday pay
- Bonus payments*
- Wages owed

** Please note, if bonuses are regular and form part of an individual's annual earnings, then they may be subject to fall within the tax-free £30,000.*

I summarise using some examples.

Example 1:

Joe is made redundant with redundancy pay of £22,000 and payment in lieu of notice of £10,000. The £22,000 is tax free, whilst the £10,000 would be taxable as income.

Example 2:

Shirley is made redundant with redundancy pay of £37,500, payment in lieu of notice of £15,000 and a one-off bonus of £4,000. Therefore, £30,000 of the redundancy pay is tax free, with £7,500 being taxable as income in the same fashion as the payment in lieu of notice and bonus payment.

Example 3:

Geoff is made redundant with a redundancy pay of £20,000. Geoff's role included a company car and laptop which he is keeping and they have been given a cash value of £15,000. Other parts of the redundancy package (payment in lieu of notice and holiday pay) total £8,000. Therefore, Geoff would be taxed on £13,000. This is a total of the £8,000 and £5,000 of the redundancy pay as the cash values of the car and laptop push him over the £30,000 tax free limit.

Income Tax – Have you paid the right amount?

Income tax is calculated on an annual basis, this means that your annual personal allowance for the year is divided into 12 and apportioned against your monthly income. If you are made redundant part way through the year you may have paid too much or too little tax. A useful exercise would be to calculate how much you believe you should have been taxed and challenge it if you are unsure. Either way, paying too much or too little tax, it is your responsibility to contact and notify HMRC.

Future planning and the power of pensions!

Paying into a pension can be very tax efficient due to the tax advantages a pension offers, chiefly tax relief on the way in via pension contributions. You could **potentially** avoid paying tax on the redundancy pay amount above £30,000 i.e. the taxable element. By making a pension contribution for taxable funds, tax relief is added back on to the amount at your highest marginal rate; 20% added on at source within the pension, and for higher or additional rate tax payers, the additional tax relief can be reclaimed via the HMRC.

Redundancy can be a stressful process and speaking to a financial adviser to understand those concerns can help relieve some of the financial worries. At Wingate Financial Planning we understand that life can present challenges; we take time to listen, understand and provide the necessary support. Please do get in touch.