UK: Employment Update

In this month's Update we consider some of the recommendations made by the Investment Association in its annual letter to remuneration committee chairmen in relation to payment in lieu of notice and the classification of good/bad leavers. In addition we examine recent case law on: (i) calculating and taking holiday entitlement when working patterns change; and (ii) how withdrawing a job offer because of an unfavourable reference can amount to disability discrimination. We also have an update on the Government's proposals to amend the tax treatment of termination payments and to consider a new statutory test for employment.

Key issues

- Investment Association Principles of Remuneration
- Calculating holiday entitlement when working patterns change
- The consultation on the tax treatment of termination payments
- New guide to the recruitment of transgender staff
- New statutory test on employment status on the horizon
- Withdrawal of a job offer in response to an unfavourable reference is disability discrimination

Investment Association Principles of Remuneration

The Investment Association (IA) has published an update of its Principles of Remuneration together with its annual letter to remuneration committee chairmen highlighting areas of concern for shareholders. There is little substantive change to the principles themselves but a number of points of note for UK listed plcs in the letter, particularly ahead of the 2016 AGM season. The letter sets out areas which the IA says its members have asked to be re-emphasised to companies:

Salary increases

Investors are concerned by the level and frequency of salary increases, especially those above inflation. The IA notes an increasing number of investors are of the opinion that executive directors should not receive any regular salary increases.

Salary increases will continue to be scrutinised and companies should have a "clear and explicit rationale" for any increase to director and senior executive salaries.

Leavers

The IA reiterates that remuneration committees must take a robust approach when making decisions on remuneration for leavers, particularly where they deem someone to be a good leaver who would not automatically fall into that category.

Companies should also give a "full justification" of why they consider someone should be a good leaver. This will give rise to some interesting debates for remuneration committees on the leaver treatment of executives who either resign or leave by mutual agreement.

It remains to be seen what sort of justification investors will consider satisfactory in practice, where the remuneration committee should document its decision making process, and how and when the thought process must be disclosed.

Service contracts

The IA notes that the majority of members remain in favour of 12 month notice periods. They are, however, keen to see the same notice period for both the company and the director.

One point of interest for any companies putting in new director contracts is that the IA expects new contracts to allow companies to withhold pay in lieu of notice (PILON) payments during any regulatory or disciplinary investigation; although this is not reflected in the principles of remuneration themselves. It is standard practice to include similar

provisions in bonus schemes providing for the retention of any bonus until such time as the outcome of any investigation (regulatory and/or disciplinary) is determined. This approach is perhaps slightly less straightforward in relation to the withholding of a PILON payment. In many cases, the question of making a PILON will simply not arise; for example where an employee is suspended pending an investigation the employer is unlikely to dismiss. Equally, if an employee resigns during an investigation an employer may place the employee on garden leave rather than exercise a PILON clause in order to facilitate their engagement in the investigation process more readily.

If an investigation is ongoing and the employer elects to exercise its PILON option in some complex cases investigations can take a significant amount of time, years rather than days, to be concluded. Prospective candidates may, therefore, baulk at the inclusion of such a provision in their service agreement. In some cases, an employer may wish to exercise a PILON provision but may not be in a position to share with the employee that he/she is the subject of a regulatory investigation.

The Investment Association letter and Revised Principles of Remuneration can be found here.

Calculating holiday entitlement when working patterns change

If an employee works part time, their holiday entitlement is pro-rated to reflect the part time working arrangements. What happens if work patterns change part way through a holiday year? The European Court of Justice (ECJ) has recently provided some guidance on the approach to calculating holiday entitlement in relation to a worker whose working pattern changes part way through the holiday year.

G's contract provided that her working hours and days varied from week to week. Her holiday year began on 1 June. During her final year of employment , G took seven days of holiday a month and a half into the holiday year. At that time, she was working only one day a week. Later that holiday year, G asked if she could take a week's leave. By this time she worked a pattern of 12 days on and 2 days off. Her employer erroneously refused the holiday request on the basis that the week of leave she had taken had far exceeded her annual holiday entitlement and was the equivalent of seven weeks' holiday as she was only working a one day week at the time she had taken it.

The ECJ was asked to consider whether holiday entitlement that has already accrued should be recalculated in a scenario where the employee changes their working pattern part way through the holiday year.

The ECJ did not agree. It held that a distinction does have to be made between the different working patterns for the purpose of calculating holiday entitlement; however, a new calculation only needs to be carried out in respect of a period in which the working hours increased. There is no need to recalculate the holiday entitlement in relation to the part time period of work merely because the working hours have been increased.

A number of other principles in relation to the holiday entitlement of workers that change their working patterns can be extracted from the judgment as follows:

- Where there is a change in working pattern, holiday entitlement must be calculated pro –rata in respect of each working pattern period(s);
- A change in working pattern does not alter the amount of holiday accrued during an earlier working pattern;
- Holiday accrued in an earlier working pattern period can be taken in a subsequent working pattern holiday period;
- Any holiday taken in an earlier period of part time work which exceeded the holiday entitlement for that period must be deducted from the holiday entitlement during the subsequent period in which the worker increases their working time;
- Where a worker moves from full time to part time working hours the holiday entitlement accrued during the full time period of work cannot be reduced and may be taken during the subsequent period of part time work; and
- The method for calculating holiday entitlement during employment and for the purposes of calculating pay in lieu of accrued but untaken holiday on termination is the same.

Judicial or legislative clarification is still required for some holiday pay issues. How should holiday pay be calculated where holiday accrued during a part time period is taken during a full time period of work? The Working Time Regulations 1998 provide that holiday pay should be calculated with reference to the worker's rate of pay before the holiday is taken not the rate of pay that applied at the time that the holiday was accrued. Questions also remain unanswered about how to calculate the rate of holiday pay where an employee receives overtime payments and/or commission and what reference period should be used.

[Greenfield v The Care Bureau Limited]

Consultation on the simplification of the tax treatment of termination payments

In our August/September Update we reported on the Government consultation paper's proposals to simplify the tax treatment of termination payments. The proposals included the following:

- All payments in lieu of notice (whether contractual or not) will be treated as earnings and subject to income and national insurance contributions (NICs);
- The introduction of a new exemption from income tax and NICs for redundancy payments to be available to employees once they have 2 years' service with the same employer or with an associated employer.;
- Redundancy payments would become taxable and NIC'able if the employee is re-engaged to do a similar job for the same company or an associated company within a 12 month period;
- The current foreign service exemption that exempts a termination payment (in full or in part) from income tax if it relates to employment that includes a period of foreign service will be removed;
- The exemption from tax in relation to legal fees incurred in connection with the termination of employment will be removed; and
- Two new exemptions will be introduced for payments made in connection with unfair or wrongful dismissal and discrimination.

The timeframe for implementation of any changes to the current rules was not set out in the consultation. The recent Autumn Statement was also silent on this issue. However, the Revenue have now indicated that the responses it has received to the consultation have highlighted the complexities involved in this area and, as such, the Government wishes to give further consideration to its proposals. It is now expected that more information on any changes to the taxation of termination payments will be published next year.

The consultation paper can be found here.

Guide to the recruitment of transgender staff

The Government Equalities Office has recently published a guide to the recruitment and retention of transgender staff aimed at providing practical advice, suggestions and ideas. The Guide can be found here

Employment Status: new statutory test on the horizon?

The employment status of an individual will dictate the nature of statutory employment rights enjoyed by them and the statutory obligations owed to them by the 'employing' entity as well as the nature of the obligation to deduct tax and national insurance payments. For employment law purposes, an individual may be an 'employee', a 'worker' or a self employed contractor. Employees and workers both enjoy various statutory employment rights; workers enjoy less statutory protection but are entitled to paid holiday and to receive the national minimum wage. From a tax perspective, individuals are either employed or self employed. There is no intermediate category of 'worker'.

Unfortunately, the dividing line between employment and self employment is not always straightforward and can depend on whether the status is being determined for the purposes of employment or tax law. In some cases an individual may be regarded as an employee for one purpose and self employed for another.

The Office of Tax Simplification (OTS) recommended earlier this year that there should be a joint review of the possibility of agreed employment status principles between HM Revenue and Customs, HM Treasury, the Department for Work and Pensions and the Department for Business Innovation and Skills.

The Government has now agreed to this proposal and a working group is to be set up which will, amongst other things, consider the benefits of a statutory employment status test. Unfortunately, the Government has shied away from a freestanding review on employment status which suggests that clarity on employment status being achieved via a statutory test is some time away. The Government will however be creating an employment status portal with all of its guidance on employment status including both employment rights and tax.

Withdrawal of a job offer in response to an unfavourable reference is disability discrimination

A recent Employment Appeal Tribunal (EAT) decision illustrates the potentially adverse consequences of withdrawing a job offer as a result of receiving a negative reference which was motivated in part by the candidate's absence record.

During her employment with X, C had significant periods of absence over two years due to a medical condition that was a disability for the purposes of the Equality Act 2010 (EqA). C applied for, and was offered, subject to satisfactory references, a job with Y. She accepted the offer. On behalf of Y, a number of references were taken up by P; one of

these mentioned that C had been absent for two periods during a 12 month period due to surgical procedures.

Another brief reference was supplied by T who had been C's former line manager at X. Because of its brevity, P followed up with a phone call; during this conversation T told P that she felt that C was unsuitable for the role at Y; she also referred to C's significant absence. P did not ask P why she had that view. As a result of this negative reference, P withdrew C's job offer. C brought claims of discrimination arising from disability against both X and Y.

Discrimination arising from disability occurs if a disabled person is treated unfavourably because of something arising in consequence of their disability. A defence is available if it can be demonstrated that the unfavourable treatment was a proportionate means of achieving a legitimate aim ('objective justification defence'). No liability can arise, however, if the person responsible for the unfavourable treatment did not know and could not reasonably have expected to know that the individual was disabled.

In relation to the claim against X, the issue was why T gave the negative reference and whether there was evidence from which it could be inferred that C's absence was the reason? The EAT held that there were facts from which it could be inferred that a reason why T made the comments about C's unsuitability for the new role was C's absences. T knew of C's disability. The unfavourable treatment (i.e. the unfavourable reference) arose as a result of the absences and the absences were disability related. Because X did not run any objective justification defence C's claim against X of discrimination arising from disability was upheld by the EAT.

In relation to the claim against Y, it was held that P as a doctor with a high level of awareness of medical conditions should reasonably have been expected to know that C had a disability because one reference expressly referred to two periods of absence in a 12 month period and T too had mentioned C's significant absence. P had treated C unfavourably by withdrawing the job offer. He had done so because of T's comments that C was unsuitable for the job. T had made those comments because of C's absence record which arose in consequence of C's disability. Y was vicariously liable for the acts of its employee P. Y did not raise an objective justification defence, therefore, the EAT upheld C's claim against Y.

This decision appears to produce a somewhat harsh outcome for the prospective employer acting on an unfavourable reference. However, it illustrates that a prospective employer may be found to have constructive knowledge of a candidate's disability by being made aware of their absence records. In this case P was fixed with such constructive knowledge because he was medically qualified and ought to have reasonably known C was disabled from the absence information shared with him. It might also be the case that an experienced HR practitioner might also be reasonably expected to know that a candidate has a disability if they are given details of extensive absences.

It should be recalled that it is possible to defend a claim of discrimination arising from disability by demonstrating that the unfavourable treatment was a proportionate means of achieving a legitimate aim. In this case, neither respondent raised an objective justification defence. Prospective employers who are alarmed by a candidate's absence levels need to act with caution before withdrawing a job offer or rejecting a job application.

[Pnaiser v NHS England & Anr]

Contacts

Chris Goodwill
Partner

Imogen Clark
Partner

Mike Crossan
Partner

Alistair Woodland
Partner

Tania Stevenson
Senior Professional Support Lawyer

T: +44 (0) 20 7006 1000
F: +44 (0) 20 7006 5555

To email one of the above please use:
firstname.lastname@cliffordchance.com