HR Rely Guidance

Guidance on Pay in Lieu of Notice

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Guidance on Pay in Lieu of Notice

Introduction

Where an employer decides to terminate an employee’s contract, it is not unusual for it to do so by paying in lieu of notice. There are a number of things that employers should consider when paying in lieu of notice and pitfalls that employers need to avoid. This note sets out the points employers should take account of prior to paying in lieu of notice.

Is there a contractual right to pay in lieu of notice?

The first point an employer should consider is whether or not there is a contractual right to pay in lieu of notice. Many employers, whilst preferring to pay in lieu of notice, often choose not to have the contractual right to do as this would mean that the payment is taxable. That is not to say that payments in lieu of notice where there is no right in the contract will always be tax free, this will depend on the circumstances and it is best to speak with your HR Rely adviser for further advice in these circumstances. The Government proposes to reform termination payments with effect from April 2018. The published draft legislation on this provides that all payments in lieu of notice, whether contractual or otherwise, will be subject to tax and NI. Although the employer may have the contractual right to pay in lieu of notice, this does not give the employee the contractual entitlement to be paid in lieu of notice. For this, there would have to be some further wording entitling the employee to be paid in such a way, which would be very unusual.

If there is no right in the contract for the employer to pay in lieu of notice but nevertheless the employer chooses to do so, then the employer will be in breach of contract, otherwise known as wrongful dismissal. This can have consequences for the employer. Where the employer is in breach, then the employee would be entitled to damages to put him in the position he would have been in had he worked his notice. This is dealt with in more detail further on. One of the other consequences is that if the employer is in breach of contract, then it is prevented from relying on other terms of the contract. If the contract has post-termination restrictions then an employer who pays an employee in lieu of notice in breach of contract will be prevented from relying on those clauses. It is for this reason alone that many contracts have a contractual pay in lieu of notice clause.

Paying in lieu in accordance with the contract

Where a contractual pay in lieu of notice clause is exercised, it means that the employee’s employment comes to an end as of that date. The employer may wish to specify in the contract what specifically the employee will be paid in lieu e.g. is it limited to salary?

The employee will be entitled to be paid statutory holiday entitlement up to the date of termination but not beyond into what would have been the notice period. This is because the employment legally comes to an end on the date of termination. Whether the employee is entitled to be paid for contractual accrued holiday entitlement up to the termination date but over and above the statutory entitlement will depend on the wording of the contract.
Statutory continuity of service – Impact of Pay in lieu

Whilst an employee may have been paid in lieu of notice, contractually or otherwise, and his/her employment ended at that point, for the purposes of calculating service for claiming unfair dismissal and statutory redundancy pay, a different date may be classed as the effective date of termination. This does not change the date that an employer gives the employee as the date of termination but it is important that an employer recognises this to understand whether statute would deem the employee’s contract to have ended at a later date and thereby allow the employee to claim unfair dismissal and/or in determining what the employee’s entitlement to statutory redundancy pay is. In calculating continuity of service for the purposes of unfair dismissal, the effective date of termination is taken as the date when the employee’s employment would have come to an end had he/she been provided with his statutory notice. Similarly in calculating redundancy, credit has to be given for any increase in age or service during what would have been the employee’s statutory notice period. For more information in relation to the effective date of termination, speak with your HR Rely Adviser.

Paying in lieu in breach of contract

Where an employer decides to pay the employee in lieu of notice but in breach of contract, the employee would have a claim for damages to put him in the position he would have been in had the contract been properly been performed i.e. had he worked his notice. It is not safe to assume that all an employer has to do is pay an employee in lieu of salary, car allowance, pension contributions and there will be no damages. The employer should look at what the employee’s contract entitles him/her to and make sure that the employee is paid in lieu and/or his benefits retained. If the employee is provided with private health cover then the employer should look at continuing this during what would have been the notice period or paying him in lieu of what it would cost to obtain a comparable benefit during the notice period. Other areas to consider are death in service benefits and whether there is scope to retain this under the scheme during what would have been the employee’s notice period.

Under the Working Time Regulations an employee is entitled to accrued holiday pay on termination in the same way as if the contract was terminated in accordance with the contract. Similarly whether the employee would be entitled to be paid for accrued contractual holiday pay over and above this depends on the contract. The other point to consider is what about holiday that would have accrued during the notice period? As the employer is terminating the contract in breach, that holiday entitlement would have continued to accrue had the employee worked their notice. However the question of whether the employee would has suffered a loss would depend on whether the employer could have required the employee to take holiday during the notice period.

Effect of subsequently discovered gross misconduct

It is rare but there are occasions when an employer, having decided to pay in lieu of notice, discovers that the employee has committed an act of gross misconduct which would have entitled the employer to have dismissed the employee without notice and without pay in lieu of notice. How does this impact on any pay in lieu of notice?

This will depend on whether the employer has elected to exercise a contractual right to pay in lieu of notice or pays in lieu of notice in breach of contract. Where the employer decides to pay in lieu of notice in accordance with the contract, then the employer is not ordinarily entitled to withhold payment as the pay in lieu of notice is a debt and not
damages for wrongful dismissal. For this reason the employer may wish to include a clause in the pay in lieu of notice clause allowing it not to make the payment in lieu, or else to recover it, in the event that it is subsequently discovered that the employee had committed an act of gross misconduct prior to the employer terminating the contract with pay in lieu of notice.

If the employer wrongfully dismissed the employee but subsequently discovered that the employee had committed an act of gross misconduct, the employer may rely on this in defending a claim for damages in respect of a wrongful dismissal claim. If such circumstances arise, then you should seek advice from your HR Rely adviser.

This guidance note has been prepared as a general guide only. It is not a substitute for professional advice which takes account of your specific circumstances and any changes in the law and practice; at the time of the preparation of this note various changes to the relevant provisions may be pending. The subjects covered constantly change and develop. No responsibility can be accepted by the firm or the author for any loss occasioned by any person acting or refraining from acting on the basis of this note. The copyright in this guidance note is owned by Weightmans LLP.