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Department for
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Correspondence

DBT response to the Post Office Horizon IT inquiry's first interim report: compensation

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Introduction

1. The department welcomes the inquiry's interim report of 17 July 2023. It reiterates the intention, recognised in the report, that all postmasters affected by the Horizon scandal should receive full, fair and prompt compensation.
2. The following paragraphs set out the department's response to the report's specific recommendations.

Recommendations 1 and 3

The Horizon Compensation Advisory Board should not be prevented from monitoring individual cases in which compensation has been or is to be determined by paragraph 4 of its Terms of Reference. It must be one of the core duties of the board that it monitors whether compensation payments are full and fair.

The Horizon Compensation Advisory Board shall, as part of its advisory role, consider whether, in its view, full and fair compensation is being paid out to applicants under the 3 schemes. It shall advise the minister and the Post Office accordingly at 3-monthly intervals.

3. Recommendations accepted in part

The advisory board's aim is to help the department to ensure fair and prompt compensation to postmasters affected by the Horizon scandal and related issues. The department agrees that, in delivering this aim, it may be helpful for the advisory board to be given anonymised information about individual cases.

However, the department endorses the view expressed by the board, in the report of its 31 July meeting and in its letter of 15 August 2023 to the inquiry, that it would not be "possible or advisable for us to intervene in the determination or outcomes of individual cases, nor to give an opinion on individual outcomes, or an opinion that full and fair compensation is being paid out to individuals".

4. The Terms of Reference allow the advisory board to advise the minister whenever it sees fit. Reports of its 6-weekly meetings are communicated to the minister and published.

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Recommendation 2

The Horizon Compensation Advisory Board shall produce written reports in respect of each of their meetings in relation to each of the 3 schemes and publish the same within 21 days of the date of each meeting.

5. Recommendation accepted

Written reports of board discussions are already published at the Horizon Compensation Advisory Board page (https://www.gov.uk/government/groups/horizon-compensation-advisory-board).

Reports of earlier meetings are available at the Group Litigation Order Compensation Scheme Advisory Board page (https://www.gov.uk/government/groups/group-litigation-order-glo-compensation-scheme-advisory-board).

They are issued within a week unless the board agrees otherwise.

Recommendation 4

If the Horizon Compensation Advisory board as constituted consider it necessary, the number of persons appointed to the board should be increased so as to ensure that the board has sufficient capacity to perform the functions set out above.

6. Recommendation accepted

The department will keep under review the case for expanding the board, in discussion with its current members.

Recommendation 5

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The Department for Business and Trade (DBT) shall take such steps as are necessary within 28 days of the date hereof, to seek appropriate directions under section 306 of the Insolvency Act 1986.

This is to enable a court to resolve the difference of view between DBT and Moore UK and/or it shall take all appropriate steps, including providing appropriate legal funding, so as to enable a sub-postmaster to seek appropriate directions under that section.

7. Recommendation accepted

The department and the inquiry share the view that none of the group litigation order (GLO) compensation payable to bankrupt claimants should be diverted to insolvency practitioners to meet their costs and creditors. Most insolvency practitioners have accepted this, but Moore UK, which is the trustee in bankruptcy in respect of 9 GLO bankrupt claimants, have not.

1. The department has instructed counsel to submit an application on its behalf for a direction from the court and has asked for this to be expedited. The department will be asking one postmaster affected by Moore's stance to be named as an interested party without the need to participate in proceedings themselves.

The department has written to affected postmasters to inform them about the actions it is taking and reassure them that they will be fully compensated.

Recommendation 6

DBT shall publish in as much detail as it reasonably can and as soon as it reasonably can, its proposals for ensuring that applicants to all schemes are treated equally and fairly. This is as far as their liability to or exemption from Income Tax (IT), Capital Gains Tax (CGT) and Inheritance Tax (IHT) is concerned as the same relates to compensation payments under each scheme.

9. Recommendation accepted

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Payments under the GLO scheme and the compensation for overturned convictions (OC) are exempt from IT, National Insurance contributions (NICs) and CGT. On 19 June, the government announced arrangements for ensuring fair treatment in respect of IT, NICs and CGT for Horizon Shortfall Scheme (HSS) claimants.

Initial offers under HSS did not account for the tax on compensation when paid as a lump sum, which means that postmasters were not necessarily restored to the position they would otherwise have been in. Top-up payments are the quickest and most efficient way to address this issue and will be exempt from tax.

Details are set out in Annex A. Payments from all 3 schemes are exempt from IHT.

Recommendation 7

HM Government shall bring forward and use its best endeavours to ensure that legislation is enacted so as to allow payments of compensation under GLOs to be made to applicants after midnight on 7 August 2024 if that proves to be necessary.

10. Recommendation accepted in principle

The department is determined to deliver the GLO scheme by August 2024. If it were to appear nearer the time that the deadline was likely to be missed, the government would of course consider whether legislation was necessary.

Recommendation 8

No applications for compensation to HSS shall be entertained after such date as shall be agreed by the Minister/ DBT, the Post Office and the Horizon Compensation Advisory Board.

11. Recommendation accepted in part.

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The department will discuss and agree an appropriate closing date with the Post Office. Advice will be sought from the advisory board and the department will notify the inquiry and potential claimants of the decision when made.

Annex A: comparison between Horizon compensation schemes on tax

1. This note provides further explanation of the tax treatment across the 3 compensation streams: OC, HSS and the GLO scheme.
2. Across all compensation streams, no claimants will pay more tax than they would have at the time of the shortfalls. The intervention on HSS is designed to put claimants in the fairest possible position as to their counterparts in GLO and OC.

There will be some HSS claimants with no or litle current income who receive more generous awards due to the assumptions made but we think that the pragmatic solution that we have announced is the fairest, simplest and fastest way to resolve the issue and ensure that postmasters receive full compensation as soon as possible.

In summary:

- postmasters with OC or participants in the GLO scheme will not be required to pay any IT, NICs, or CGT. This is because the award is calculated net of tax, that is, an amount in respect of tax is deducted in the calculation of the compensation award. The payments are not then subject to IT, CGT and NICs
- postmasters participating in the HSS will be required to pay IT and NICs on some elements of the compensation they receive. They will also be required to pay CGT where relevant, but it is unlikely that any compensation would attract CGT
- HSS claimants will receive an additional payment on top of their compensation. This additional payment will compensate the postmaster for any tax that they are liable to pay on their compensation above the basic rate (20%). In practice, it will be more generous for postmasters with little or no other income, who are less likely to pay tax at the higher or additional rates as a result of the compensation payment
- the additional payment to HSS claimants will be tax exempt so there will be no further tax or NICs to pay on this amount, making the top up straightforward and final

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- the government will not collect any IHT that may arise in relation to payments made under the HSS, the GLO scheme, and the OC scheme to victims of the Post Office Horizon scandal

1. For each of the schemes, there are taxable and non-taxable elements. For example, where the loss relates to what would have otherwise been employment income, it is taxable. The Post Office and DBT seek to follow the “Gourley principle”, which states that a person should not be placed in a better or worse position than if the contract had been carried out.
2. The distinction between the schemes is the point when IT is applied to relevant heads of loss. For postmasters with OC and those who were part of the GLO, an amount in respect of IT is deducted as part of the calculation of the award in the year in which it would have been earned to provide a net figure. For example, gross earnings in each year are identified and then tax deducted at the appropriate rate for that year.

Interest is then applied to the net figure. Combined these payments constitute the compensation award. This award is tax exempt, meaning there is no liability for the claimant to pay tax on the award received.

1. The methodology used to calculate payments is in adherence with the Gourley principle. For example, if the claimant receives an award for loss of earnings, this should reflect the amount they would have received if they had continued to work as a postmaster and paid tax on their earnings over the years.

This is consistent with the objective to put claimants back in the financial position that they would otherwise have been in.

1. On the HSS, loss of earnings awards are based on the gross remuneration that the postmaster would have expected to have received from the Post Office. IT is then due to HM Revenue & Customs (HMRC) in the year the compensation is paid.

Post Office has rightly withheld IT from the award, although this may not match the postmaster’s actual liability. This approach allowed the Post Office to make awards under the scheme without requiring detailed tax information from the claimant.

However, Post Office and government recognise this regrettably did not fulfil the Gourley principle for some claimants because the lump sum payment means they are in higher tax brackets than they might otherwise have been if they had received the earnings over a number of years.

1. This would have created a discrepancy between the HSS and the GLO/OC schemes whereby, if tax arrangements were left as they were originally designed, HSS claimants would have been subject to higher tax

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bills than if the HSS scheme was designed in the same way as the other schemes.

2. Addressing this discrepancy is difficult given the large number of compensation awards that have already been made under the HSS.

Whilst including HSS in the regulations to exempt GLO and OC from IT, NICs and CGT, would have created parity of tax treatment in theory, it would not have created parity in outcomes between the schemes because of the different way in which awards are calculated.

Introducing an exemption for the HSS would mean HSS claimants receive a gross award which is subject to no IT, putting them in a better position than their counterparts in the other schemes.

1. This is why the top-up solution was favoured, to make sure that whilst HSS claimants are still liable to pay some tax on their gross compensation awards this top-up will make this commensurate with what they are likely to have paid at the time of employment, an application closer to the Gourley principle.

An explanation was previously provided by the department on how the top-ups would be calculated and the rationale behind it. This is repeated below for ease: Top-up payments will therefore be calculated so that no postmaster pays more than the basic rate of tax on their compensation.

This is in line with the intention to restore the postmaster to the position they would have been in if they had kept their jobs and received remuneration and paid tax in the normal way.

It will be assumed that the taxable elements of the compensation will be subject to the additional rate of tax (45% in England, Wales and Northern Ireland, 47% in Scotland). The top up payment will then be for the difference between the compensation taxed at the additional rate and the compensation taxed at the basic rate. These additional payments will be exempt from IT, CGT and NICs.

For example, if the taxable amount of compensation was £100,000, Post Office will assume that, due to the postmaster's other earnings, this will be taxed at 45%. Our intention is for the recipient to be treated as if they were taxed at the basic rate (20%).

The top up would therefore be for £25,000 – the difference between £45,000 of assumed IT and £20,000 of IT. This example is for illustrative purposes and does not account for any allowances that the postmaster may have, including the termination allowance.

Further to this, for taxable interest applied to non-taxable heads of loss (for example, Horizon shortfalls), a different approach will be taken. We don't

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think it is right that this element of compensation should be taxed and therefore we will issue a top up payment which will cover any subsequent tax bill to the postmaster.

Top ups will be calculated to account for the difference between the additional rate of tax and 0% to mitigate the impact of tax entirely.

In the above example, this would mean a £45,000 top-up, assuming all the £100,000 is interest on non-taxable heads of loss. This is consistent with the OHC and GLO, where the tax exemption means that interest applied to non-taxable heads of loss is also exempt from IT, CGT and NICs.

1. There are a small number of sub-postmasters who have structured their business through a corporate entity, these businesses are within the GLO and HSS compensation frameworks.

The government announced draft legislation at legislation day on 18 July 2023, which sets out the proposed remedy for corporate entities, which aims to create a similar level of taxation as if the compensation had been paid directly to the directors, employees or shareholders of the corporate in an individual capacity.

1. Compensation for postmasters with OC and the members of the GLO, are also exempt from CGT. This exemption does not extend to HSS but as CGT is primarily applied to profit from the sale of an asset, compensation payments are unlikely to be subject to CGT.
2. There is consistency of treatment between all 3 schemes on IHT. The government has already legislated to exempt payments made to claimants under OC from IHT and has announced its intention to legislate to exempt from IHT payments made under the HSS and the GLO scheme.

To ensure that HSS and GLO claimants have certainty over their tax position prior to legislation being introduced, HMRC will not collect any IHT in relation to payments made up to the date the legislation comes into force.

Any IHT paid by the personal representatives of estates who did not previously qualify for relief from IHT on HSS and GLO scheme payments are entitled to a refund from HMRC.

Annex B: summary of tax approach by scheme

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	Overturned convictions	Group litigation order	Horizon shortfall scheme
Calculation of awards	Net	Net	Gross
Shortfalls	Not taxable	Not taxable	Not taxable
Personal losses (for example, personal injury)	Not taxable	Not taxable	Not taxable
Loss of earnings	Taxable (deducted in calculation)	Taxable (deducted in calculation)	Taxable (taxed on final award)
Compensatory interest (3.45% compound)	Not taxable (interest added to net award)	Not taxable (interest added to net award)	Taxable (interest added to gross award, taxed on final award)
Income Tax and National Insurance contributions on final award	Not payable (exempt)	Not payable (exempt)	Payable
Inheritance Tax	Not payable (exempt)	Not payable (exempt)	Not payable (exempt)
Capital Gains Tax	Not payable (exempt)	Not payable (exempt)	Not exempt but compensation is unlikely to attract CGT
Top-up payments (exempt from IT, NICs, IHT and CGT)	Not payable	Not payable	Payable