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OFFICIAL SENSITIVE

BEIS HSS SteerCo Risk Update – HSS Tax Position

Purpose

To update SteerCo on a risk that officials have identified that claimants may seek to dispute their tax treatment upon receipt of offers due to the impact on their tax position (moving to a higher rate).

Recommendation

That SteerCo:

- **Note** the risk presented by applicants potentially challenging the HSS tax treatment
- **Decide** whether the risk warrants further investigation or escalation

Advice

1. Following [redacted] and clearance from HMRC, the approach the Panel has taken on making offers to applicants is that offers are made gross of tax. That is, that it is up to the applicant to consider their own tax position and pay tax accordingly. This was flagged to SteerCo in early 2021 with no decision taken to challenge the approach at the time (notably, due also to the likely delays to scheme delivery that seeking the required legislation would have brought).

2. So far in the delivery of the HSS this has not posed an issue as lower value claims were dealt with first. This meant the compensation sums received by applicants were unlikely to materially affect their tax position for the year.

3. However, as we are now dealing with more complex and significant claims, the offers made by Panel are now much more substantial, as demonstrated by the steady rise in the average offers made by POL (Sept-21 it was IRRELEVANT IRRELEVANT). Given the cases we currently see going through HMC, and reviewed by officials as per the agreed process, this rise will continue.

4. Therefore, it is likely that the lump sum compensation payments received by applicants now for more significant claims **will push those applicants from the basic tax rate to the higher tax rate in the year they receive it**, resulting in a higher tax bill and thus leaving each applicant with less compensation than they would expect. If the 26-month loss of earning element was, for example, received over two tax years, instead of as a lump sum, applicants might not be required to pay the higher tax rate. There is a risk that applicants may dispute their treatment in the DRP as unfair.

5. To put this into context, there is no blanket policy that publicly funded compensation schemes are accompanied by a tax exemption. It should however be noted that notable HMG funded schemes, such as Windrush[1], Infected Blood[2] and Equitable Life[3], have provided various tax reliefs.

6. Currently, no cases have been disputed based on the additional tax due (probably as tax returns are not required to be filed until early next year and the relative lower value of cases to date). There is also no allowance for additional higher tax rate compensation in the HSS financial model i.e. whilst certain heads of loss are taxable (see attached, the model and what we bid for through the HSS business case is just for the principal compensation amount.

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7. We have flagged this issue to HMRC who are currently focusing their efforts on a potential tax exemption for the OHC cohort (given magnitude and nature of claims). BEIS Legal is also considering the issues from a public law perspective.

8. As an illustration, using the current HSS model (v2.6.5) and high-level and simple assumptions[4], applicants may have to pay between £5m - £10m (cumulatively) in additional tax due to entering the high tax bracket.

9. Should a material number of applicants challenge the position either through the DRP or by other means (in the media, through Parliament or the Inquiry) it could potentially pose a serious risk to the HSS, either through the potential need to seek further funding or, in a worst-case scenario, the unwinding of all HSS offers in which the applicant has been put into the higher tax bracket.

10. Officials are monitoring the situation closely, in particular the issues that are raised in the DRP, and are seeking at this stage to put the risk on SteerCo's radar for noting. Should SteerCo however note the risk warrants further investigation or escalation we will re-engage the discussions with POL, HMRC etc.

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[1] https://www.gov.uk/government/publications/windrush-compensation-scheme-payments-exemptions-from-income-tax-capital-gains-tax-and-inheritance-tax/windrush-compensation-scheme-payments-exemptions-from-income-tax-capital-gains-tax-and-inheritance-tax

[2] https://www.gov.uk/government/publications/income-tax-tax-relief-for-compensation-payments-from-the-infected-blood-schemes/income-tax-tax-relief-for-compensation-payments-from-the-infected-blood-schemes

[3] Chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/317764/elps_main_doc_final.pdf

[4] Key assumptions: 25% additional tax (difference between 45% and 20%) incurred by the claimants, full £30k tax-free allowance available, 50% of the termination cases compensated as non-termination cases for the lower range. NB. the calculation is highly indicative and does not take into account individual claimants' tax situation.