What should employers be considering ahead of the introduction of the new unfair dismissal rules on 1 January 2027?

On 1 January 2027, the period of service needed to claim unfair dismissal will be reduced from two years to six months. At the same time, the cap on the compensatory award for unfair dismissal (currently the lower of £123,543 or 52 weeks' pay) will be removed. Employers considering making dismissals will need to take great care with the timing of dismissals if they wish to avoid uncapped claims. In this briefing we consider how an employer should approach dismissals of employees with under two years' service and dismissals of employees who already have two or more years' service.

Dismissal of employees who have <u>under</u> two years' service before 1 January 2027

Where an employer dismisses an employee before 1 January 2027 the current unfair dismissal regime will apply. This means that an employee will qualify to bring an ordinary unfair dismissal claim only if they have two years' service by the date of dismissal. However, employers must take note of an important rule which may give employees with under two years' service a route to bring an ordinary dismissal claim.

The Employment Rights Act 1996 provides that where an employee is dismissed without notice (or without sufficient notice), their statutory minimum notice entitlement (which is one week for employees who have between one month and two years' service) is added on to their actual termination date, which is known as the "effective date of termination" (the "**actual EDT**"). This adding on of statutory notice creates a notional effective date of termination (the "**notional EDT**"), which is used for certain limited purposes, namely to:

- decide whether an employee has sufficient qualifying service to bring an unfair dismissal claim;
- decide whether the employee has sufficient qualifying service to have the right to request written reasons for their dismissal; and
- calculate their "basic award" for unfair dismissal (which is based on complete years of service).

A similar approach is taken where inadequate notice has been given, save that here the statutory notice entitlement runs from the date that the inadequate notice is given rather than the actual EDT.

Employers cannot avoid these rules by making a payment in lieu of notice ("**PILON**") as it cannot replace statutory notice.

The logic for this extension is that an employee should not be denied the right to bring an unfair dismissal claim as a result of being dismissed without statutory minimum notice (or with inadequate notice) shortly before they would have acquired the right to bring the claim. The exception is that the extension rule will not apply where an employee has been summarily dismissed for gross misconduct, and this is because no statutory notice is owed to them in those circumstances.

Herein lies the danger for employers, because from 1 January 2027 the qualifying period needed to bring an unfair dismissal claim will be reduced from two years to six months. Therefore, if an employee has a notional EDT extending into 2027 *and* they have at least six months' service by that date, they should qualify to bring an unfair dismissal claim even where their actual EDT falls in 2026.

Importantly, the Employment Rights Act 1996 provides that notional EDT is only used for the three limited purposes discussed above – it is *not* used for the purposes of the compensatory award. On that basis, where the actual EDT falls in 2026 but the notional EDT extends into 2027, any compensation would fall to be assessed by the compensatory award regime in place as at the date of the actual EDT in 2026 (i.e. the capped regime with a maximum compensatory award of the lower of £123,543 or 52 weeks' pay). This significantly reduces an employer's risk exposure and provides an incentive to ensure that the actual EDT in any prospective dismissal falls in 2026 rather than 2027.

How does the extension rule work in practice?

The starting point is to identify the actual EDT. Where an employee is dismissed without notice the actual EDT will be the date on which the termination takes effect. This will be when the employee actually learns of the dismissal or has a reasonable opportunity to do so (and what is "reasonable" is not defined in law and will turn on the facts of the case). Therefore, where an employer communicates the termination to the employee face-to-face, the actual EDT will be that date. Where the employer communicates the termination by email or letter, for example, the actual EDT will be the date on which the employee reads the email or letter, or the date on which they would have had a reasonable opportunity to do so.

Once the actual EDT has been identified, assuming that no notice was given, the statutory notice period is added on to identify the notional EDT. As above, the statutory minimum notice entitlement for employees who have been employed for between one month and two years is one week. Importantly, the statutory notice only begins to run from the day *after* the actual EDT rather than from the actual EDT. The last day of the statutory notice period is counted as the notional EDT. This means that a dismissal without notice of an employee with under two years' service **would need to take effect at least eight days before 1 January 2027** to avoid a notional EDT of 1 January 2027. Where insufficient notice has been given, the statutory notice would run in parallel with any notice given by the employer.

Worked examples

The best way to understand the application of this tricky rule is to consider a few worked examples.

Example 1: Employee with eight months' service dismissed at the end of December 2026 (paid in lieu of notice):

- John starts work on 22 April 2026 and is dismissed with immediate effect on 27 December 2026 and paid in lieu of notice. This means 27 December 2026 is the actual EDT.

- John has eight months' service and so is entitled to one week's statutory notice. Because John has been dismissed without notice, his statutory notice entitlement of one week will be added on to identify his notional EDT.

- The one week's notice starts to run on 28 December 2026 and expires on 3 January 2027.

- The 3 January 2027 is the notional EDT. John has eight months' service on the notional EDT. On that date, the qualifying period to bring an unfair dismissal is six months' service. Therefore, John should qualify to bring an unfair dismissal claim.

- However, John's actual EDT is 27 December 2026. This is the date from which his time limit to bring the unfair dismissal claim will start to run (i.e. three months less one day) as time limits are not extended by the statutory notice period. Therefore, John must bring his claim by no later than 26 March 2027, subject to any extension to this date obtained by virtue of Acas Early Conciliation.

- If John wins his claim, he will not be eligible to receive a basic award as he does not have at least one continuous year's service (and the basic award calculation is based on complete years of service). John will be eligible to claim a compensatory award, although this would be awarded under the capped compensatory award regime in operation on his actual EDT and not the uncapped compensatory award regime in force from 1 January 2027.

<u>Example 2: Employee with just under six months' service dismissed at the end of December 2026 (paid in lieu of notice):</u>

- Lucy starts work on 2 July 2026, meaning her six-month service anniversary would fall on 1 January 2027.
- Lucy is dismissed with immediate effect on 24 December 2026 and paid in lieu of notice. The 24 December 2026 is the actual EDT.
- Lucy has five months' service and so is entitled to one week's statutory notice. Because Lucy has been dismissed without notice, her statutory notice entitlement of one week will be added on to identify her notional EDT.
- The one week's notice starts to run on 25 December 2026 and expires on 31 December 2026
- Lucy's notional EDT is 31 December 2026. This means she does not qualify to bring an unfair dismissal clam as the qualifying period in force on that date is two years' service, which she does not have.
- If Lucy's actual EDT had been one day later, then her notional EDT would have been 1 January 2027, and she

would have qualified to bring a claim.

Example 3: Employee with three months’ service dismissed in January 2027 (paid in lieu of notice):

- Alex starts work on 11 October 2026, meaning his six-month service anniversary would fall on 10 April 2027.
- Alex is dismissed with immediate effect on 15 January 2027 and paid in lieu of notice. The 15 January 2027 is the actual EDT.
- Alex has three months’ service and so is entitled to one week’s statutory notice. Because Alex has been dismissed without notice, his statutory notice entitlement of one week will be added on to identify his notional EDT.
- The one week’s notice starts to run on 16 January 2027 and expires on 22 January 2027.
- Alex’s notional EDT is 22 January 2027. This means he does not qualify to bring an unfair dismissal claim because he does not have six months’ service on that date.

Example 4: Employee with just under six months' service dismissed at the end of December 2026 (with insufficient notice):

- Emily starts work on 30 June 2026, meaning her six-month service anniversary would fall on 29 December 2026.

- Emily is given her notice of dismissal on 25 December 2026. Her employer states that she should work until the end of the following Monday (28 December 2026) to hand over her matters, and they will pay her in lieu of the remainder of her notice. The 28 December 2026 is the actual EDT, because this is the day that her notice period expires.

- Emily has five months' service and so is entitled to one week's statutory notice. Because she has been dismissed with some notice, but not her full one week's entitlement, the remainder of her statutory notice entitlement will be added on to identify her notional EDT.

- The one week's statutory notice starts to run on 26 December 2026, the day after she is given notice by her employer. It runs in parallel to the few days' notice that they asked Emily to serve and expires on 1 January 2027.

- Emily's notional EDT is 1 January 2027. This means she does qualify to bring an unfair dismissal clam as the qualifying period in force on that date is six months' service, which she has accrued by that date.

- However, any compensation would be awarded under the capped compensatory award regime in operation on her actual EDT and not the uncapped compensatory award regime in force from 1 January 2027.

Dismissal of employees who have two years’ service or more before 1 January 2027

The position is somewhat more straightforward for employees who have accrued two years’ service before 1 January 2027. These employees will already qualify to bring a claim of unfair dismissal under the current rules. This means that they do not need to rely on the extension rule discussed above in order to qualify to bring a claim (nor to qualify for the right to request written reasons for the dismissal).

However, the extension rule is still relevant to them for the limited purpose of calculating their basic award in any unfair dismissal claim. The basic award is calculated by reference to complete years of service. Therefore, if an employee is dismissed without notice (or with inadequate notice), shortly before an anniversary of their employment, the extension rule will add their statutory notice to their actual EDT to identify the notional EDT for basic award purposes. This may mean that they the pass an anniversary date and achieve a higher basic award.

As discussed above, however, the extension rule does not apply in relation to the compensatory award. This means that the applicable rules are those in force on the actual EDT. This is a crucial point for employers since means that provided the actual EDT is on or before 31 December 2026, the current capped compensatory award rules apply.

Since **actual EDT** is the key reference date for compensatory award purposes, employers will need to **ensure that the actual EDT falls no later than 31 December 2026**. If an employer dismisses without notice by this date, the employee would still be entitled to bring an unfair dismissal claim but would only be able to claim a capped compensatory award not an uncapped one.

Great care needs to be taken to ensure the actual EDT falls no later than 31 December 2026. As discussed above, the actual EDT is the date that the employee actually learns of the dismissal or has a reasonable opportunity to do so (and what is “reasonable” is not defined in law and will turn on the facts of the case). To be certain that the employee has actual knowledge of the dismissal, the employer should communicate it face-to-face. It should be remembered that where termination is communicated by email or letter, for example, the actual EDT will be the date on which the employee reads the email or letter, or the date on which they would have had a reasonable opportunity to do so. This may be different to the date on which the email or letter is sent by the employer and introduces uncertainty about when the actual EDT falls.

Clearly, there is a risk to leaving a dismissal until 31 December 2026. The employee may well be on holiday over the Christmas and New Year period, potentially leaving the employer unable to communicate the termination in person. Relying on an email or letter is extremely risky. If the employee does not see it until the following day, they would likely be able to claim the actual EDT is 1 January 2027, meaning an uncapped claim would then be available to them.

Even if the dismissal is communicated at the eleventh hour, the other major risk with rushing through a dismissal in this way is that a fair dismissal process is unlikely to have been followed. This would gift an unfair dismissal claim to the employee (albeit that it would be a capped claim). Employers can avoid this unforced error by planning ahead now to identify dismissals that are needed prior to 1 January 2027 and putting the appropriate dismissal processes in train in good time. Some fair dismissal processes take considerable time (e.g. performance or ill-health dismissals) meaning the planning around those needs to happen as soon as possible.

Key takeaways

Employers considering dismissing employees who have **under two years' service** should ensure they do so before 1 January 2027, when the reduced qualifying period comes into force. Critically, the dismissal must be timed correctly to avoid the extension rule taking the notional EDT into 2027. This will usually mean dismissing by no later than 24 December 2026.

Where the dismissal relates to an employee with **two or more years' service**, the dismissal must take place no later than 31 December 2026 and, ideally, much earlier, so as to avoid arguments that the employee did not have knowledge of the dismissal until 1 January 2027.

This briefing and the examples given above provide general guidance only and do not amount to legal advice. These calculations are complex and can be finely balanced, and employers should always seek legal advice on this issue in good time before any proposed termination. If a dismissal is on the cards, or becomes necessary shortly before 1 January 2027, employers should seek urgent legal advice.

Finally, employers should also remember that where the reason or principal reason for dismissal is one of a number of "automatically unfair" reasons, such as having blown the whistle, an employee will usually be entitled to bring the claim from Day 1 of their employment and will not need two years' service. Employees in this position with under two years' service would not need to rely on the extension rule in order to bring a claim. And in a minority of automatic unfair dismissal claims, compensatory awards are uncapped. From 1 January 2027, all such claims will be uncapped.