



Employment

Changes to tax on termination payments What you need to know

The way in which tax and National Insurance (NI) contributions are calculated on termination payments is changing. This note summarises the changes.

Background

Legislation has been introduced in the Finance (No 2) Act 2017 and Finance Act 2018 that changes the rules on the tax and NI treatment of termination payments. The changes started coming into force on 6 April 2018.

Redundancy payments

The £30,000 tax exemption will remain, and statutory redundancy payments will continue to benefit from it. However, enhanced redundancy payments and other compensation made in connection with the termination of employment will not automatically fall within this exemption.

Payments in lieu of notice

From 6 April 2018, post-employment notice pay (ie pay in lieu of notice) will be fully taxed as general earnings, whether the payment is contractual or not. This means that all payments

in lieu of notice will be subject to tax and to employee's and employer's NI contributions. The legislation includes complex provisions for calculating post-employment notice pay, which are beyond the scope of this note. However, it should be noted that where employment comes to an end before when it would otherwise come to an end had full notice been given, some or all of the payments made to an employee on termination may be characterised as post-employment notice pay.

The balance of the termination payment above post-employment notice pay is then subject to the normal rules regarding termination payments, including the £30,000 exemption, and is taxed accordingly.

Employers' NI

It is proposed that all termination payments above the £30,000 threshold will be subject to employer's NI on the excess above £30,000 from 6 April 2019. The existing employee's NI exemption will be retained, even if the payment exceeds £30,000.

Abolition of foreign service relief

The foreign service relief (FSR) exemption has been abolished from April 2018 for UK resident employees (except in relation to seafarers). FSR wholly or partly exempts non-contractual termination payments from tax where an employee has worked abroad for part of their employment. From April 2018, a more limited 'exception in certain cases of non-UK based employment' applies. This means that the whole termination payment will be brought into charge if the employee has had earnings subject to UK tax at any point during their employment.

Exemption for injury

Payments for injury to feelings will fall outside the exemption for termination payments relating to death, injury or disability (where there is no financial cap), except where the injury amounts to a psychiatric injury or other recognised medical condition.

Future changes

It is proposed that HM Treasury will have the power to increase or decrease the £30,000 exemption.

What employers need to do

Employers will need to take these changes into account, as they are likely to increase the cost of any proposed settlement.

The changes are also likely to impact on individuals; if they receive lower net payments than under the old rules, they may look to employers to make up the difference.

Employers should also think about amending contracts of employment to include contractual payments in lieu of notice (PILON) where they do not already contain them. This is because there is now no tax advantage to not having a contractual PILON. Including such a clause means that the employer will not be in breach of contract by making a PILON, which means that the employee will still be bound by post-termination provisions, such as restrictive covenants. In addition, a contractual PILON can be limited to basic pay only so that benefits will not have to be paid for what would have been the notice period, which will reduce the cost to the employer.

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