



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

The Finance (No 2) Act 2017 introduced changes to the rules on the tax and NI treatment of termination payments. The changes took effect from 6 April 2018.

### Redundancy payments

The £30,000 tax exemption remains, and statutory and contractual redundancy payments will continue to benefit from it (but see below in relation to payments in lieu of notice). Compensation for unfair dismissal, however, 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) is fully taxed as general earnings, whether the payment is contractual or not. This means that all payments in lieu of notice are 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. 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 expected (although the enabling legislation has not yet been passed) 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 2020. The existing employee NI exemption will be retained, even if the payment exceeds £30,000.

### Abolition of foreign service relief

The foreign service relief (FSR) exemption was 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. A more limited 'exception in certain cases of non-UK based employment' now 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 need to consider the effect of these changes, 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 they would have done before the changes, 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 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.

---

#### For further information please contact:



**Karen Plumbley-Jones**  
Managing Associate

T: +44 (0)1752 67 7903  
E: karen.plumbley-jones@  
wbd-uk.com



**Jeremy Smith**  
Partner

T: +44 (0)191 279 9803  
M: +44 (0)798 071 5502  
E: jeremy.smith@  
wbd-uk.com

© Copyright 2019 Womble Bond Dickinson (UK) LLP. All rights reserved. This communication is provided for general information only and does not constitute legal, financial, or other professional advice so should not be relied on for any purposes. You should consult a suitably qualified lawyer or other relevant professional on a specific problem or matter. Womble Bond Dickinson (UK) LLP is authorised and regulated by the Solicitors Regulation Authority. "Womble Bond Dickinson", the "law firm" or the "firm" refers to the network of member firms of Womble Bond Dickinson International Limited consisting of Womble Bond Dickinson (UK) LLP and Womble Bond Dickinson (US) LLP. Each of Womble Bond Dickinson (UK) LLP and Womble Bond Dickinson (US) LLP is a separate legal entity operating as an independent law firm. Womble Bond Dickinson International Limited does not practice law. Please see [www.womblebond Dickinson.com/legal](http://www.womblebond Dickinson.com/legal) notices for further details.

