

Termination Payments – forthcoming changes in 2018 & 2019

General Background Information

An employee's employment may be ended for a number of reasons including, dismissal, resignation, retirement and death.

When an employment comes to an end, an employee often receives a financial package that is made up from a variety of different elements. This financial package is often referred to as a termination payment. Examples of the different elements of a termination payment include unpaid salary, damages, payment in lieu of notice, payment for a restriction on future actions, compensation for loss of office and the provision of a non-cash benefit after termination.

It is important that employers correctly identify each element of the termination package as there may be different tax consequences for each part.

From 06 April 2018 there are some changes coming into legislation regarding termination payments, with some additional changes also coming into legislation from April 2019. There has also been clarification on 'injury to feelings' payments. The measures are intended to bring fairness and clarity to the taxation of termination payments.

In order to help our customers understand these changes and update their procedures accordingly, we have produced this document.

The main areas of change are:

- The treatment of Payments in Lieu of Notice (otherwise known as PILONs)
- Foreign Service Relief
- National Insurance contributions for Employers
- Clarification as to the meaning of 'Injury to Feelings'

Treatment of Termination Payments Pre 18/19

Treatment of Payments In Lieu Of Notice (PILONs)

In general a PILON is a payment made to an employee in place of an agreed notice period prior to an employment being terminated. This can cover a range of payments in numerous circumstances.

A contractual PILON is a payment made in place of a 'contractually' agreed upon notice period. This agreed period of notice is usually contained within a contract of employment, redundancy terms, staff policy handbook or one of any number of similar documents. Where a contractual PILON is operated the amounts paid during this notice period are earnings and are subject to PAYE.

In the scenario of 'Gardening Leave', where an employee is given notice but told not to attend work during this period, this is not a PILON as proper notice has been received. The employee is still being paid as normal but it not required to attend work in this period.

However, if an employment had been terminated and the employee was not allowed to work the full duration of any prior agreed notice period then there has been a breach of contract. Any payments made in respect of that breach of contract in lieu for the lack of notice are classed as breach of contract and are chargeable to income tax under s401 ITEPA 03 to the extent the amount exceeds the £30,000 threshold and no NICs are due.

Foreign Service Relief

A payment or benefit is exempted from charge under Section 401 ITEPA 2003 if it relates to an office or employment that includes sufficient periods of Foreign Service.

There are numerous conditions to qualify for this exception, such as length of service, when service was accrued and full information can be found in [EIM 13680](#).

National Insurance Contributions

Currently there are no National Insurance Contributions due for employees or employers on payments which are taxable under s401 ITEPA 03. This will continue until April 5th 2019 (please see 'Termination Payment Changes from April 2019' below).

Termination Payments Changes From April 2018

Treatment of Payments In Lieu Of Notice (PILONs)

Contractual PILONs are currently chargeable to income tax as earnings. From April 2018 non contractual PILONs will also be chargeable to income tax and class 1 National Insurance contributions as general earnings. The employer is required to identify the amount of basic pay that the employee would have received if they had worked their notice period, even if the employee leaves the employment part way through their notice period. This amount is called post-employment notice pay (PENP) and is calculated using a formula set out in the legislation at section 402D ITEPA 2003. The amount will be treated as general earnings and will not be subject to the £30,000 Income Tax threshold. Statutory redundancy payments and the balance of any termination payments that are not PENP remain chargeable to income tax as specific employment income and are subject to the £30,000 threshold.

Foreign Service Relief

Foreign Service relief on termination payments for UK residents is removed by amendments to sections 413 & 414 ITEPA 03, although it is retained for seafarers.

This change will ensure that all employees who are UK resident in the tax year their employment is terminated will be liable to income tax on their termination payment in the same way, regardless of whether or not they have worked abroad during their employment.

Injury to Feelings - Clarification

The legislation around 'injury to feelings' has caused confusion for some employers, so the changes introduced also clarifies the position for payments of this type. The exemption from tax for termination payments relating to death, injury or disability (exempted by s406 ITEPA 03) does not apply in the case of a payment made in respect of 'injury to feelings'. The exemption does still apply in cases of psychiatric injury or other relevant recognised medical conditions.

Any payments made to compensate for injury to feelings on termination of employment are likely to be subject to tax and fall within the scope of the £30,000 exemption.

Termination Payments Changes From April 2019

National Insurance Contributions

From 6th April 2019 tax and secondary National Insurance contributions will be aligned for termination payments. As such all termination payments taxable under s401 ITEPA 03 over the £30,000 threshold, that aren't post-employment notice pay, will be liable to employers National Insurance contributions (class 1A NICs).

Links to Guidance

New guidance reflecting the changes can be access [here](#).

To review the actual legislation in full, please follow the attached [link](#).

Further details on the changes to Foreign Service relief can be viewed on the following [link](#).

This is an area that HMRC will review as part of normal compliance activity with customers. Therefore, if you identify any issues when applying this guidance or you have not correctly taxed termination payments, please contact your HMRC Customer Compliance Manager.