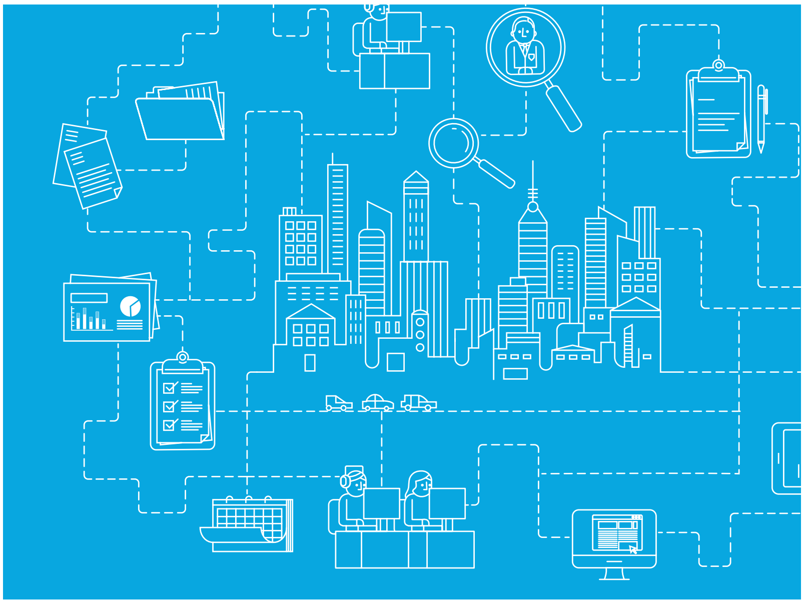
The tax and National Insurance treatment of termination payments is changing – are you prepared?



Starting from 6 April 2018, the Government is introducing a series of legislative reforms to the employment tax and National Insurance Contributions ("NIC") treatment of payments connected with the termination of employment. These reforms are being introduced with the broad aim of simplifying the current rules, but they actually go much further than this and "tighten" the rules considerably. In many cases, the new rules will also result in increased tax and National Insurance liabilities being payable on termination packages. The key changes to be aware of are as follows:

For employments which cease on or after 6 April 2018 the concept of Post-Employment Notice Pay ("PENP") is being introduced. Calculating PENP can be complex and its introduction will have the effect of treating all payments in lieu of notice as earnings subject to tax and Class 1 NIC under PAYE.

For employments which cease on or after 6 April 2018 it is expected that foreign service relief (except in relation to seafarers) will be abolished for employees who are resident in the UK in the tax year in which their employment ceases, and who receive their termination payment on or after 13 September 2017. This will change the tax and NIC treatment of termination payments paid to employees who have spent significant periods of their employment working overseas.

From 6 April 2019 it is expected that all qualifying termination payments above the £30,000 (unless it is varied) threshold will be subject to employer's Class 1A NIC in addition to tax. This will increase employer NIC costs on qualifying termination packages which exceed £30,000.

What could these changes mean for you? Six practical considerations.

Calculating PENP

Working out the PENP and ensuring that the correct amount is subjected to tax and Class 1 NIC will be an additional burden for employers to deal with. There will be an increased focus on considering the specifics of each case and there is likely to be more strain on internal resources to collate required information, and apply the correct tax and NIC treatment.

Foreign service relief

It will be more difficult for employers to give foreign service relief via the payroll as they will need to be aware of the employee's tax residence position for the tax year in which their employment is terminated, but this may not be known until the end of the tax year. As a result, the timing of termination payments to such employees may change.

Negotiating termination packages

Termination packages are often negotiated by reference to the net benefit the employee receives. If an employee is likely to be worse off as a result of these changes, negotiations may result in their employer compensating them further. This could result in employers paying higher gross amounts to employees, further pushing up costs.

Staff training and procedures

All staff involved in or dealing with termination payments must be made aware of, and be suitably trained on, the changes. Termination payment policies and internal termination payment calculators and procedures used by employers will all also need to be revisited and amended. Employment contracts for future employees may also need to be changed, particularly in relation to payment in lieu of notice clauses.

Payroll processes

Current payroll parameters may need to be reviewed to ensure that termination payments can be correctly dealt with via the payroll from 6 April 2018. Payroll software suppliers and providers may also need to be contacted to ensure that these changes are being addressed.

Timing of termination payments

Where there are plans in place or on the horizon, it may be possible to utilise existing rules, and mitigate tax and NIC costs, by bringing matters forward and ensuring that the cessation of employment occurs before 6 April 2018 or 6 April 2019, depending on the potential value of the termination payments.

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