Simplification of the tax and National Insurance treatment of termination payments

Employment Tax | Personal tax

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ATT, CIOT and LITRG have responded to the HMRC and HMT consultation document on draft legislation to simplify the income tax and National Insurance contributions (NIC) treatment of termination payments

HMRC and HMT published the consultation on draft legislation to simplify the income tax and NIC treatment of termination payments to follow up a 2015 consultation.

LITRG response

LITRG had raised concerns that the original, 2015 proposals would not deliver genuine simplification for employers and employees. Rather they seemed to be aimed at raising more revenue for the government; in addition, we feared they would disadvantage low-income employees.

LITRG was able to provide a more positive reception for the 2016 consultation and draft legislation. We welcomed the fact that the revised proposals remove many of the distinctions in treatment between the different types of payments in lieu of notice (PILONs) as this will assist in reducing complexity. However, the general distinction between contractual and non-contractual termination payments will remain (on the basis that this is fairer), and we note that, as a result, employers will still need to consider the nature of constituent parts of the termination payments and in some cases will need to perform fairly complex calculations in order to determine the amount to be treated as earnings and the amount eligible for the £30,000 exemption.

LITRG was also pleased that the £30,000 threshold for the exemption for eligible termination payments will be retained, as this should ensure continued support for those individuals losing their jobs. In conjunction with this, we welcomed the fact that employees, already in a vulnerable position due to losing their job, will continue not to have an NIC liability on their termination payment.

We recommended that HMRC consider the impact that these changes will have on tax credits and universal credit, noting that HMRC and DWP must ensure that any changes that affect tax credits and universal credit are communicated to claimants, to ensure that they treat them correctly when telling HMRC and the DWP about their income and capital.

We also pointed out that it will be necessary to provide guidance and educational resources for employers, particularly for the smaller employers that have fewer resources.

ATT response

The ATT response focused on the complexity of the required calculations and recommended a complete rewriting of ITEPA 2003 Chapter 3, to provide a more logical structure to the legislation. It would be helpful to have an introductory outline and clear signposting so that readers were taken through the relevant steps. It also recommended the provision of Toolkit-style guidance and consideration of the creation of an online calculator in order to provide greater certainty for employees and employers.

CIOT response

In its response, the CIOT expressed disappointment that the government had not taken the opportunity afforded by the work of the Office of Tax Simplification (OTS) to simplify the income tax and NICs treatment of termination payments. We think that the proposed ‘PILON’ legislation to tax all payments not directly related to the termination of the employment is far too complicated and will create a huge amount of confusion for employers, employees and HMRC alike. When responding to last summer’s consultation we said that, in principle, removing the distinction between contractual and non-contractual termination payments would mean one less step when determining the tax analysis and ought to introduce simplicity. Unfortunately,

it seems the opportunity to simplify has been missed.

Instead the distinction between contractual and non-contractual payments has been retained and a very complicated approach to determine which parts of a termination payment can benefit from the £30,000 exemption has been added. If the legislation is amended as the government has proposed advisers, employers, employees and also HMRC will have to grapple with 'post-employment notice income', a 'default period', 'trigger point', and 'expected bonus income' payments plus other benefits by way of bonus that employees 'could reasonably be expected to receive' (a) before the end of the employment, (b) during the default period, or (c) a bonus which is apparently not covered by either (a) or (b), together with an anti-avoidance provision in regard to 'arrangements' to reduce 'general earnings', all coupled with a 3 year look-back rule and more.

Furthermore, the CIOT believes that imposing employer NIC on termination payments in excess of £30,000 is simply revenue raising with no quid pro quo, for example an increase in the £30,000 threshold, especially as the original intention when the OTS was first briefed to consider this area was that any changes to the treatment of termination payments would be revenue neutral. We also think that the introduction of employer only NIC is not only complicated but could potentially could result in errors arising (e.g. as to whether and to what extent a payment made on the termination of an employment is liable to employer NIC, employee NIC, both or neither).

Finally, the CIOT has urged the government to rethink its decision to remove Foreign Service Relief (FSR) (for all except for seafarers). We believe that it is a mistake to abolish FSR. FSR is as relevant today as it was when it was introduced. Termination payments arise in a whole range of circumstances including redundancy, breach of contract, irreconcilable differences between employer and employee, a personal thank you for a relationship that has endured over many years etc. and it is our view that it is right to reflect FSR in deciding what should properly be sourced to the UK and what to non-UK service. We believe that FSR is logical and fair, and that it has worked well in practice over many years.

The LITRG response is available on the LITRG website.

The ATT response is available on the ATT website.

The CIOT response is available to read in full on the CIOT website.