

Changes to taxation of termination and notice payments – are you ready?

04 APRIL 2018

Libby Payne

SENIOR ASSOCIATE | UK

CATEGORY:
ARTICLE



From 6 April 2018 employers will need to think more carefully when making termination payments to employees.

It used to be the case that in the absence of a contractual payment in lieu of notice (or '*PILON*') clause, an employer could choose to terminate an employee's employment before the end of the notice period and make a payment to an employee as '*damages for the loss of the notice period*' which could be paid without deduction of tax (up to £30,000) and without being subject to NICs. By contract, contractual PILONs were subject to both deductions for income tax and also payment of NICs as they were treated as earnings flowing from a provision in the employee's contract.

The Government has now introduced legislation to address this inconsistency of treatment and effectively provide that payments in lieu of notice, whether contractual or non-contractual, are always subject to tax and NICs. This new regime will apply where an employee is dismissed on or after 6 April 2018. Employers will now have to ensure that on termination at least an amount equivalent to payment for the remaining notice period (or post-employment notice pay – '*PENP*') is subject to tax and NICs.

The new legislation is somewhat complex and includes formulae for calculating PENP in cases where employees are paid monthly and cases where they are paid at different intervals or are entitled to notice that is not expressed in months (such as statutory notice, which is calculated in weeks). There are also a number of complexities and pitfalls around when the calculation needs to be carried out and what payments are and are not included. PENP may also need to be calculated even where there is a contractual PILON and the amount due under the contractual PILON may differ from the PENP figure.

There are also some situations where it is not at present clear what the PENP would be – for example if an employee was summarily dismissed and a payment made at a later date to settle a claim. It is hoped that as these first payments are made further guidance will be issued.

In the meantime, you should check carefully that PENP has been calculated correctly and the appropriate tax and NICs paid before making any '*ex gratia*' or other tax free payments to employees (albeit statutory redundancy pay can always be paid tax free). You may also want to update your templates and consider including PILON clauses if you do not already have these in your contracts.

If you would like to discuss any of the above, please speak to a member of our employment team.

Authors

Libby Payne

SENIOR ASSOCIATE | LONDON

Employment

 +44 20 7597 6608

 libby.payne@withersworldwide.com