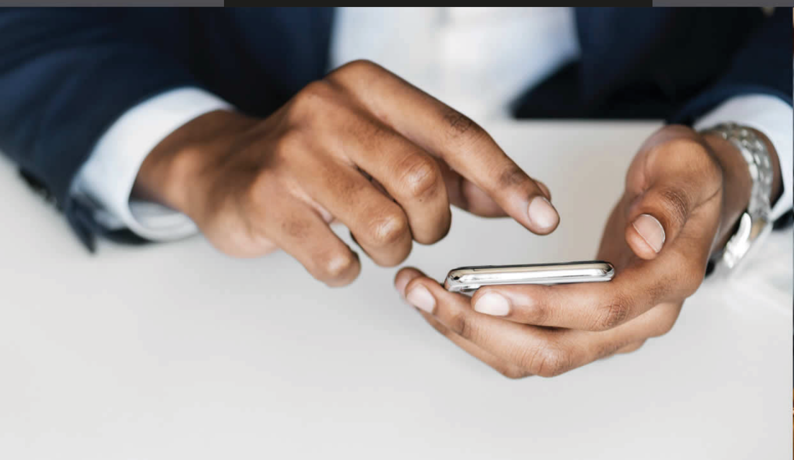
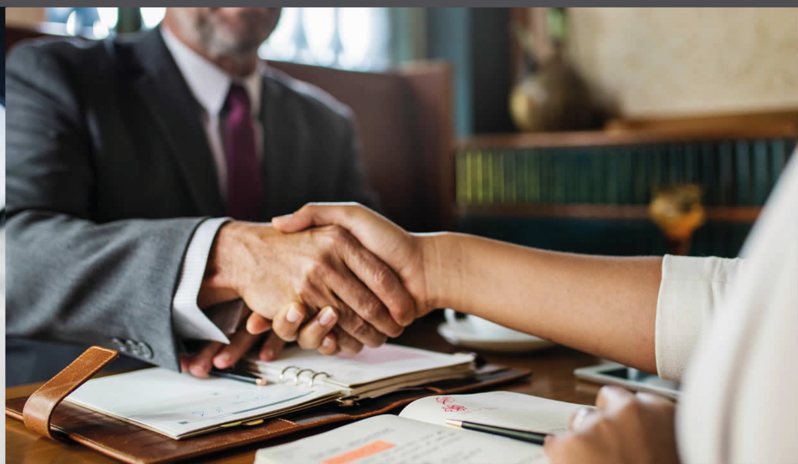
abbiss Cadres

Taxation of termination payments after 6 April 2018

BRIEFING NOTE

Changes to termination payment taxations

Major changes to the way termination payments are taxed came into effect from 6 April 2018. Most significantly, amounts of a termination award which are equal to the basic pay an employee would have received if he or she had worked the full notice period (known as "post-employment notice pay") will be treated as income from the employment. This briefing note provides a step-by-step plan to help companies and advisors calculate the amount of a termination payment which is treated as income from employment under the new rules.

Our step-by-step guide

Step 1

Work out whether or not the employee will serve out the full contractual notice period.

Information you will need:

- The date notice was given and the date the employment will terminate
- The contractual notice period

Points to watch out for:

- The notice period for the purposes of the new rules is the notice period required to be given by the employer. Do not assume the same notice period is required to be given by both employer and employee

If the full contractual notice period is served, the new rules will not in practice impact the tax treatment of the termination award, and there will be no need to go through the remaining steps below.

Step 2

Calculate the employee's basic pay for the last complete pay period before notice was given.

Information you will need:

- The employee's basic pay. This is the employee's pay: (a) excluding variable elements such as overtime pay and bonus and commission payments, the value of benefits-in-kind and various other exceptional items, and share-based payments such as gains when options are exercised, but (b) including amounts sacrificed under salary sacrifice arrangements
- Details of any salary sacrifice arrangements in which the employee participates
- The employee's pay period. This is the period for which an employee is paid, for example a calendar month

Points to watch out for:

- The employee's pay-slip will show the employee's basic pay after deduction of any salary sacrifice amounts. It is important to remember to add salary sacrifice amounts back in to the pay as shown on the pay-slip
- Where the employee has not worked for a complete pay period (which could be the case, for example, where a probationary period did not work out), the pay period is taken as the period from the date the employment started to the date notice was given, and the amount of basic pay is the amount the employee received for that period (worked out on the basis above)

Step 3

Calculate the number of days in the "post-employment notice period". This is the period between the last day of the employment and the last day of the notice period

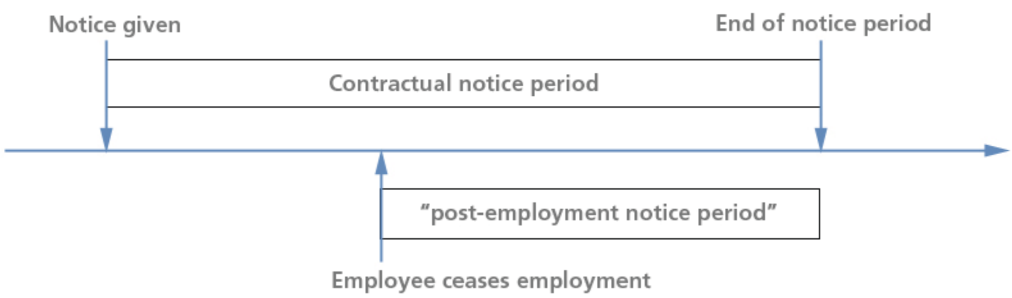
Information you will need:

- Same as for Step 1

Points to watch out for:

- As with Step 1, the notice period for the purposes of the new rules is the notice period required to be given by the employer

The diagram below illustrates this calculation:



abbiss Cadres

Step 4

Calculate the "post-employment notice pay". This is the amount of basic pay the employee would have received had the employee worked the whole of the notice period.

The formula for calculating this is:

$$\frac{(BP \times D)}{P} - T$$

Where

BP is basic pay for the last complete pay period, calculated under Step 2 above,

D is the number of days in the "post-employment notice period" calculated under Step 3 above,

P is the number of days in the notice period, and

T is the sum of any amounts which are taxable as earnings from the employment, but which are not either accrued holiday pay or a termination payment. In practice, "T" is most likely to be the amount of a contractual payment-in-lieu of notice ("PILON").

Points to watch out for:

- You cannot assume that where a contractual PILON is paid the new rules will not apply. For example, the contractual PILON may be calculated on pay net of any salary sacrifice amounts. If that is the case, the amount of "basic pay" for the purposes of the formula above would be higher than pay used to calculate the PILON, and the amount subject to tax under the new rules may not be fully covered by the contractual PILON paid. It is necessary to look at the terms of the PILON carefully.

Step 5

Calculate the "relevant termination award". This is what is generally referred to as the ex gratia amount paid in consequence of the termination of the employment, less any amounts which are redundancy payments (in essence, a payment under Part 11 of the Employment Rights Act).

Information you will need:

- The total amount of the "ex gratia" termination payment
- The amount which is a redundancy payment

If the termination is not a redundancy, or not a redundancy within the scope of the Employment Rights Act, the amount of the "relevant termination award" will simply be the amount of the ex gratia termination payment.

Step 6

Work out the amount taxable under the new rules as income from employment. This is done by comparing the "post-employment notice pay" calculated under Step 4, with the "relevant termination award" calculated under Step 5.

- Where the "post-employment notice pay" is greater than the "relevant termination award", the amount subject to income tax as earnings from employment is the full amount of the "relevant termination award"
- Where the "relevant termination award" is greater than the "post-employment notice pay", the amount subject to income tax as earnings from employment is the amount of the "post-employment notice pay". The balance of the "relevant termination award" will only be subject to tax if it exceeds £30,000

How can we help?

Please let us know if you would like to discuss the impact of the new regulations on your business. Our services range from providing a full compliance check for your remuneration report with the new regulations and relevant guidance, to helping with one-off bespoke queries. We can also assist with the drafting of your remuneration policy to ensure that it is both sufficiently flexible for the next three years while also enabling the company to meet all of its existing contractual obligations to directors.

Contacts

For further information or to discuss the issues raised, please contact one of the partners below:

Guy Abbiss - Partner

D: +44 (0) 203 051 5714

T: +44 (0) 203 051 5711

E: guy.abbiss@abbisscadres.com

Alasdair Friend - Partner

D: +44 (0) 207 036 8385

T: +44 (0) 203 051 5711

E: alasdair.friend@abbisscadres.com

London office and meeting rooms:

11 Ironmonger Lane, London, EC2V 8EY   T: + 44 (0) 203 051 5711

www.abbisscadres.com   www.celiaalliance.com