



HM Revenue
& Customs



HM Treasury

Simplification of the tax and National Insurance treatment of termination payments: government response and consultation on draft legislation

Consultation document

Publication date: 10 August 2016

Closing date for comments: 5 October 2016

Subject of this consultation:	This document contains a government response to the 2015 consultation on termination payments as well as draft legislation for technical consultation.
Scope of this consultation:	To explore whether the draft legislation works as intended.
Who should read this:	The government is interested in hearing from everyone with a view on this subject, including employers, their representatives, trade organisations and any other interested parties.
Duration:	The consultation will run from 10 August 2016 to 5 October 2016.
Lead official:	Ruth Hopkinson, HM Revenue and Customs
How to respond or enquire about this consultation:	Written responses to the consultation can be sent by email or post to: employmentincome.policy@hmrc.gsi.gov.uk Employment Income Policy Team Room 1E/08 100 Parliament Street London SW1A 2BQ
Additional ways to be involved:	Meetings will be arranged with external representatives to discuss the legislation. If you are interested in attending a meeting, please contact the Employment Income Policy Team at the email address above.
After the consultation:	Feedback on the legislation will be taken into account as a second draft is developed for publication with the draft Finance Bill 2017.
Getting to this stage:	The publication of this government response and the draft legislation follows the policy announcement made at Budget 2016.
Previous engagement:	A consultation on the policy was held over summer 2015.

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Part 1: Introduction

1. In July 2015, the government published a consultation on the tax and National Insurance contributions (NICs) treatment of termination payments.
2. The government has several objectives for the tax and NICs rules on termination payments: the tax system should continue to provide support to those who lose their job; the rules should provide certainty for employees and employers; the rules should be simple; the complexity that the Office of Tax Simplification (OTS) highlighted in their report should be taken into consideration; and the rules should be fair and not open to abuse or manipulation.
3. The rules governing the taxation of termination payments are complex and can encourage manipulation by employers to take advantage of the employer NICs exemption. This is because employers can, in some circumstances, change the nature of some payments so that they become termination payments, including remuneration such as bonuses which would normally be subject to tax and NICs.
4. To meet these objectives, the government announced at Budget 2016 that it would make changes to the taxation of termination payments. From April 2018, the government will:
 - Continue to support individuals when they lose their job by ensuring that:
 - the first £30,000 of a termination payment remains exempt from income tax; and
 - any payment paid to any employee that relates solely to the termination of the employment continues to have an unlimited employee NICs exemption.
 - Clarify the scope of the exemption for termination payments to prevent manipulation by making the tax and NICs consequences of all post-employment payments consistent. In order to achieve this, the government will tax and subject to Class 1 NICs any payment that the employee would have received if they had worked their notice period, even if the employee is asked to leave employment immediately or part way through their notice period. This will also remove the confusion about the different rules for payments in lieu of notice (PILONs) by making all PILONs taxable and subject to Class 1 NICs.
 - Align the rules for income tax and employer NICs so that employer NICs will be payable on payments above £30,000 (which are currently only subject to income tax).
 - Make the following changes to the exemptions for termination payments:
 - remove foreign service relief; and
 - clarify that the exemption for injury does not apply in cases of injured feelings because of the divergence of judicial decisions about this issue.

5. The government believes that these changes will achieve the right balance between its objectives. The £30,000 income tax exemption will be retained and employees will continue to benefit from an unlimited employee NICs exemption. This will ensure that those who lose their job will be supported through the tax system. At the same time, removing the uncertainty around some types of payments will ensure that the £30,000 exemption cannot be abused and can only be used for payments that are genuinely the result of an individual losing their job.
6. Part 2 of this document sets out the government's response to the July 2015 termination payments consultation and explains in more detail how the government has decided to change the rules. This is a complex area, so the government is also consulting on the draft legislation that will bring these changes into effect from April 2018. Part 3 contains examples to illustrate how the new legislation is intended to work, asks a number of questions about the draft legislation, and provides details on how you can provide comments on that legislation. Annex A contains the draft legislation. Annex B provides a full summary of responses.

Part 2: Response to the consultation

1. The consultation document published in July 2015 set out a number of ideas for the reform of the tax treatment of termination payments. Options were considered against the following criteria:
 - simplicity: the system must be simpler for employers and employees to understand;
 - clarity: the system must be clearer and therefore provide more certainty for employees about the tax and NICs treatment to avoid additional distress at a difficult time;
 - administrative simplicity: for both employers and HMRC;
 - fairness: those who are better paid and better able to afford advice should not receive a more favourable tax and NICs treatment than those who are lower paid; and
 - affordability: it must not impose undue cost on the Exchequer.
2. The government received 109 written responses from a variety of different groups. Respondents included tax advisory firms, employers of all sizes from different sectors, and individuals. HM Revenue and Customs and HM Treasury also held discussions with stakeholders over the summer of 2015. The government is grateful to stakeholders for taking the time to consider these proposals.
3. The following pages provide a high-level summary of responses to the questions from the consultation document. They set out the government's response to the issues raised and what changes the government has decided to make. This document is structured thematically:
 - Part 2A analyses responses to questions on contractual and non-contractual termination payments, including payments in lieu of notice and preventing manipulation of the rules;
 - Part 2B outlines the NICs treatment of termination payments;
 - Part 2C considers the nature and level of the tax-free threshold; and
 - Part 2D evaluates the current exemptions, proposals for new exemptions and financial caps on exemptions.
4. A full summary of responses to each question is provided at Annex B.

Part 2A. Contractual and non-contractual termination payments and preventing manipulation of the rules

1. This chapter summarises consultation responses to questions on the different tax treatment of contractual and non-contractual termination payments, including payments in lieu of notice (PILONs), and action to prevent manipulation. It then sets out the government's response and explains the changes announced at Budget 2016 to this part of the termination payment rules.
2. To summarise, the following rules will apply from April 2018:
 - all PILONs will be subject to tax and NICs as earnings;
 - all other post-employment payments which would have been treated as general earnings if the employee had worked their notice period will be subject to tax and Class 1; and
 - payments relating directly to the termination of the employment will have a £30,000 income tax and employer NICs exemption. There will continue to be an unlimited employee NICs exemption on termination payments.

Payments in lieu of notice

3. Currently, PILONs that are included in the employment contract are treated as earnings and subject to income tax and NICs, but non-contractual PILONs are not. The Office of Tax Simplification (OTS) highlighted that this treatment is a source of confusion. On the basis that there is no clear policy rationale to treat contractual and non-contractual PILONs differently, the consultation proposed to treat all PILONs as earnings in order to reduce complexity.

Consultation responses

4. Around two-thirds of respondents agreed that removing the different tax and NICs treatment of PILONs would remove complexity because the distinction causes confusion and can result in incorrect tax and NICs being paid. Some respondents thought that the distinction should be removed on principle and the current system is unfair because it gives preferential treatment to those paid non-contractual PILONs.
5. Others thought that the tax treatment should be based on the circumstance, rather than the form of the payment, i.e. all PILONs should be treated the same. A few respondents highlighted that in their experience PILON clauses in contracts are increasing, meaning that the different treatment is an anomaly with little practical purpose.
6. Around a third of respondents did not want the distinction to be removed. The majority of these respondents felt the current system is not complex, and provides

a well-established rule which reflects the legal distinction between the two types of PILON.

Wider treatment of contractual and non-contractual termination payments

7. The consultation also considered removing the distinction between non-contractual and contractual termination payments as a way to remove complexity and prevent manipulation. The consultation explained that this would require fundamental changes to the way employment income is taxed and subject to NICs.

Consultation responses

8. Opinion was fairly evenly split. Support for retaining the distinction between contractual and non-contractual termination payments was slightly higher, on the basis that it was clear and widely understood. Some stated the distinction should not be removed as it aligned with basic legal principle that something 'contractual' is 'from the employment' and that 'non-contractual' means a payment relates directly to the termination. They argued that any payment explicitly relating to compensation for loss of the employment, such as statutory redundancy payments, should fall under the termination payment rules, whereas anything from the contract or which was customary (such as holiday pay) should be taxed and subject to NICs as earnings in the same way as salary or holiday pay would be taxed during employment.
9. A number of respondents highlighted that non-contractual termination payments can be a useful negotiating tool when ending an employment, particularly given the tax exemption. There were concerns that removing the distinction would impair this.
10. Others found the current system confusing, so were supportive of removing the distinction. The main reason given was that all termination payments are for loss of employment. Respondents felt this would provide simplicity, clarity and fairness.
11. The consultation meetings explored the issue of whether the distinction between contractual and non-contractual payments could be removed without opening the exemption to abuse. Attendees raised concerns that in order to ensure that the rules could not be manipulated, the government would have to implement additional rules which would themselves be complex and could negate any benefits of removing the original distinction.

Preventing manipulation

12. The government is aware that some employers and employees manipulate the current rules to provide the most favourable tax and NICs outcome by breaking contracts and/or creating circumstances that effectively turn a contractual payment into a non-contractual payment of damages. This can be done by breaching the employee's terms and conditions, for example by not giving minimum notice. The consultation asked how the government might prevent this manipulation.

Consultation responses

13. Some respondents said they were unaware of such practices and the current rules sufficed. However, other respondents said they had seen these practices and made a range of suggestions on how best to tackle this form of manipulation. Respondents put forward a number of ideas including a lifetime limit on termination payments to prevent serial abuse. A number of respondents suggested aligning tax and NICs so employers would not be encouraged to breach an employee's contractual terms and conditions. Another idea was that HMRC should provide clearer guidance on what constitutes redundancy under a fixed-term contract and what is compensation for ending employment.

Government response on PILONs, contractual and non-contractual termination payments and preventing manipulation

14. On the basis of responses to PILONs, the government has decided to remove the distinction between the different types. The majority supported removing this distinction and the government believes this change will provide more clarity and certainty. However, it is clear that the general distinction between contractual and non-contractual termination payments is useful and not consistently found to be complex. Removal of the distinction could add new complexity given the need for additional rules to prevent manipulation, therefore, the government has decided to retain that distinction. Nevertheless, it will ensure that only payments directly related to the termination of the employment may use the exemption. The government believes it is fair that any payments that would have been made in the absence of the termination should be taxable and subject to Class 1 NICs.
15. The government will also align the employer NICs and income tax treatment (discussed in more detail in Part 2B). The government believes that the combination of these changes will remove the incentive to manipulate the rules, and will ensure that the termination payments exemption is there to support those who have lost their job.
16. In order to determine which post-employment payments (or proportion of a payment) will be subject to the exemption, employers will need to refer (as they do now) to the employee's underlying employment contract and other terms and conditions. Any payment that covers part of the existing contractual entitlement, including the notice period even if the employee does not work it, will be taxed and subject to Class 1 NICs as earnings. Anything that is non-contractual will be the termination payment which will be taxed and subject to employer NICs on any amount that exceeds the £30,000 threshold.
17. The draft legislation is set out in Part 3 of this document, alongside some examples which show how this is intended to work in practice.

Part 2B. National Insurance contributions

1. Under the current rules income tax is due on termination payments above £30,000, but there is no NICs charge. This chapter considers responses to the proposal to align the tax and NICs treatment of termination payments and explains how the government reached its decision to charge employer NICs on termination payments which are subject to income tax.

Consultation responses

2. Following the OTS's recommendation, the government sought views on aligning the tax and NICs treatment of termination payments. The government wanted to determine whether alignment would make termination payments easier to understand and administer.
3. Respondents favoured the principle of aligning the rules. However, several were opposed, citing concerns that it could impose a financial burden on employers and have a knock on impact on employees who could end up bearing the cost through reduced pay-outs. In addition, a few respondents were concerned that increasing costs for employers could harm labour market flexibility.
4. From an administrative perspective, respondents' views were finely balanced. Those against alignment claimed the rules were well established and understood, so any change would create an administrative burden for employers. Those in favour argued that aligning the rules would be preferable if it meant following one set of guidance as opposed to two.
5. Overall, there was more support for alignment. Most respondents in favour thought it would be a positive step towards alignment of income tax and NICs more broadly and believed that the benefits of simplifying the rules outweighed the costs. It was also suggested that aligning the tax and NICs treatment of termination payments would reduce the incentive for employers to manipulate the rules to take advantage of the NICs exemption on termination payments.
6. Around 20% of respondents would support the alignment for termination payments if it was part of a broader alignment reform. Of those with no clear preference, the majority wanted to wait for the OTS's wider recommendations on income tax and NICs alignment before making a judgement on whether aligning the rules for termination payments would be a rational approach to take.

Government Response

7. The government believes that there is a case for aligning the income tax and employer NICs treatment of termination payments to make the system simpler to understand and fairer. The government is concerned about the potential for manipulation and believes that is unfair that individuals must pay tax on termination payments over £30,000 when employers are not required to pay NICs. Therefore, from April 2018, employer NICs will be due on all termination payments if they are also subject to income tax.

8. The government recognises that this will impose an additional cost on some employers but the majority of termination payments will continue to be exempt because they are less than £30,000.
9. The employee NICs exemption on termination payments will remain unchanged to minimise the impact on individuals – a concern that was raised by a number of respondents to the consultation. The government firmly believes that the decision to align only employer NICs strikes the right balance between delivering simplification for employers, and fairness for individuals who are losing their jobs.

Part 2C. Income tax-free threshold

10. This chapter reviews responses to questions regarding the level of the income tax-free threshold for termination payments. Currently no tax is due on the first £30,000 of a termination payment and no NICs are payable on any termination payment.

Consultation responses

11. The consultation considered at what level the tax-free threshold should be set. Several respondents felt the level should not be considered in isolation from any potential NICs changes. However, the vast majority of respondents did not want the existing threshold to be reduced from £30,000. Some suggested that the threshold should be updated by inflation from when it was set at £30,000 in 1988, or be index-linked in future.
12. Others felt the current £30,000 exemption was too generous and suggested it could be reduced to the level of the average termination payment (around £14,000), or the level of average salary (around £27,000), and still be sufficient to support someone who had lost their job.
13. The consultation also considered whether the exemption should be dependent on length of service. The responses were strongly against such a change, with many respondents raising concerns that this would not support simplification and would be more complex than the current flat rate. Some respondents fundamentally disagreed with the proposition and argued it could be discriminatory for certain individuals such as those who had not been in a job for a long time, who were young, part-time workers and those who had been on a career break. Others were concerned it could inhibit some employees' careers as they could be reluctant to move role. A few respondents pointed out it would be difficult to establish whether service should be specific to that job or whether it should be related to length of service at one company. Some respondents objected on principle and thought it was not the place of the tax system to reward loyalty.
14. A minority of respondents thought that an exemption on length of service could be easily understood. They pointed out that statutory redundancy pay is already linked to length of service and is something employers have to consider. Some thought this option would have the benefit of ensuring employees had genuinely been employed for a length of time.

Government response

15. Overall, the majority of respondents were not supportive of reducing the £30,000 threshold and there was no desire to have a variable threshold based on length of service. Given these responses and the government's aim of supporting those who lose their job, the government has decided to maintain the £30,000 threshold. The government felt there was not a strong enough case to increase the threshold,

particularly given the additional Exchequer cost. Maintaining the £30,000 threshold means the majority of termination payments will be free from tax and NICs.

Part 2D. Exemptions

Existing exemptions

16. There are various exemptions, reliefs and reductions that apply to termination payments in addition to the £30,000 threshold. For these exemptions to apply, the payment must be connected to the termination itself and not be contractual or salary. If the conditions of the exemption are met then there is no income tax liability even on payments over £30,000. These include payments made:

- because of the death, disability or injury of the employee;
- under a tax exempt pensions scheme;
- to a registered pension scheme;
- for liabilities and indemnity insurance;
- to HM Armed Forces;
- by a foreign government;
- where the employee has a certain type of foreign service; or
- in respect of certain legal costs.

17. The consultation asked respondents if these exemptions should remain and whether caps for certain exemptions should be put in place.

Consultation responses

Exemption for termination payments because of disability or injury

18. Nearly all respondents felt the exemption for payments for employee injury or disability should be maintained. They cited a number of reasons, including that it may be more difficult for people in such circumstances to find employment. Others felt that the purpose of the exemption should be to compensate for suffering and therefore tax simplification should not be an aim in this case.

19. However, many respondents were concerned that it may not always be used as intended and that medical advice should be required. It was also highlighted that the use of this exemption could grow if employees and employers sought to bring other payments under the exemption by claiming injured feelings.

20. A minority felt the exemption for injury and disability should be removed completely because separate exemptions add complexity.

Foreign Service Relief

21. Foreign Service Relief allows termination payments for certain qualifying individuals to be completely exempt from income tax. Employees who receive termination payments while working in the UK but who have worked for their employer outside of the UK for more than 75% of the last 20 years do not have to pay any income tax. If an employee has worked abroad but does not meet the

qualifying criteria for a 100% deduction, they may be able to receive a smaller relief which is proportionate to their time worked outside the UK for that employer.

22. Some argued Foreign Service Relief is a protection for those who work abroad and described it as a vital part of the territorial system. There were concerns that removing the relief could cause inequitable results and reduce mobility.
23. Others wanted to retain the relief but with significant simplification. Some respondents had experience of miscalculation of the relief. They felt the complexity makes it difficult even when employers seek to comply with the rules. They cautioned that any change should be safeguarded against double taxation and HMRC should adopt comprehensive territorial limits in line with the OECD.
24. Some felt it should be removed because it is rarely used and some employers do not apply it even when employees meet the criteria. Others commented that the exemption was unfair, providing a lucrative form of remuneration with little rationale.

Other exemptions

25. Most respondents thought that the other current exemptions should be maintained. In particular, respondents were keen that the exemption in respect of certain legal costs should remain because it is important for employees to take decisions on their legal settlement with independent legal advice.

Capping exempt payments

26. The majority of respondents felt that exempt payments, such as certain legal costs, should not be capped. They argued that payments would be naturally restricted because employers do not wish to make excessive payments. Some respondents argued that adding a cap would increase the burden on employers who would have to 'gross-up' any tax so employees took home the same amount. Others argued that introducing a cap would be useful and that all payments should have the same cap for consistency and simplicity.

Government response on existing exemptions

27. In line with the strong message from respondents that many of the exemptions are fair, the government will maintain the following exemptions when payments are made:
 - because of the death, disability or injury of the employee;
 - under a tax exempt pensions scheme;
 - to a registered pension scheme;
 - for liabilities and indemnity insurance;
 - to HM Armed Forces;
 - by a foreign government;
 - where the employee has a certain type of foreign service; or
 - in respect of certain legal costs.

28. As respondents pointed out, there is potential for the use of the exemption for injury to grow if it includes injured feelings. Recent divergent judicial decisions on this issue mean that the government has decided to make an amendment to clarify that the exemption does not apply in cases of injured feelings. This reflects what HMRC considers is the correct interpretation of the existing legislation. In order for the exemption to apply there must be an injury or disability of a physical or psychological nature that is sufficient to cause the employee to be unable to perform his or her job properly.
29. The government believes the Foreign Service Relief has become outdated and unnecessary. A termination payment is normally offered as a lump sum at a single point in time and for this reason, the government will tax the payment as such and from April 2018, Foreign Service Relief will be removed. Today there is a global workforce and this exceptional treatment is no longer justifiable. Those who have worked abroad will continue to benefit from the £30,000 tax-free threshold. This will help achieve the government's aims of a fairer system.
30. The government does not believe there is a strong enough case to add financial caps to the existing exemptions, or to remove the requirement to differentiate parts of the payment. The current rules are well understood and differentiating between the various components that make up the termination payment will help to ensure they are applied fairly and consistently.

New exemptions

31. The consultation asked whether there should be an exemption for payments connected to discrimination that had been awarded by a tribunal. It also considered whether there should be financial caps for such an exemption.

Consultation responses

32. If an exemption from tax and NICs for payments in connection with compensation for unfair or wrongful dismissal were to be introduced, the majority of respondents did not wish this amount to be capped because such payments are compensatory. They were concerned this would encourage use of litigation. Others felt that it was not the place of the tax system to incentivise or dis-incentivise the use of an employment tribunal.
33. Others argued that payments should compensate employees, but were concerned that without a cap employees and employers could use the exemption for further tax and NICs advantage. A number of respondents argued there should be no further exemptions and no caps. They argued that for tax simplicity the rules need to be the same.

Government response on new exemptions

34. The government does not intend to introduce any new exemptions. Additional exemptions would increase complexity and there was not a strong enough case to

add further exemptions. The existing exemptions and £30,000 threshold already provide significant support for those receiving termination payments.

Part 3. Worked examples and questions on the draft legislation

1. This section contains some practical examples of how we will expect employers to implement the new rules. Draft legislation on the income tax aspects of the new termination payments rules is set out in Annex A. NICs legislation will be published in draft in the autumn. This section raises a number of questions about the draft legislation as well as further aspects not yet included in the draft.
2. The following examples demonstrate how we intend these changes to work in practice and we would welcome views on whether the legislation achieves that aim.

Example 1: This example demonstrates the impact of the rule changes for employer National Insurance contributions which will take effect from April 2018.

An employee is told that their job is no longer required and that they will be made redundant. They are required to work the minimum statutory notice period of 12 weeks.

The employee is contractually entitled to:

- statutory redundancy pay of £14,000; and
- their gross salary of £26,000 per year;

During the worked notice period, the employee will continue to receive their salary. This amounts to £6,000 over the 12 week period. It will be subject to tax and NICs as earnings.

When the employment is terminated at the end of the 12 weeks the employee receives £20,000 compensation for loss of office. His total termination package is £34,000.

In this example the current termination payment rules and the new termination payment rules generate the same tax and NICs outcome for the employee. However, the employer will be required to pay employer NICs on the termination payment under the new rules.

Example 1		Rules up to April 2018			Rules from April 2018		
Total payment	£40,000	Income tax	EE NICs	ER NICs	Income tax	EE NICs	ER NICs
Salary received during notice period	£6,000	Earnings (Yes)	Earnings (Yes)	Earnings (Yes)	Earnings (Yes)	Earnings (Yes)	Earnings (Yes)
Termination payment (less tax-free £30,000)	£4,000	TP (Yes)	TP (No)	TP (No)	TP (Yes)	TP (No)	TP (Yes)

Example 2: This example demonstrates the impact of the rule changes for payments in lieu of notice (PILONs) which will take effect from April 2018

The employee is told that she has to leave her job immediately without working her notice. The employment contract allows for a minimum six month notice period or a PILON.

The employee is entitled to:

- gross salary of £48,000 per year; and
- a PILON which is specified in their employment contract.

The employment is terminated immediately and the employee receives:

- £24,000 PILON; and
- £40,000 compensation for loss of office.

Under the new rules, all PILONs and contractual entitlements will be subject to tax and NICs like earnings. The amount of the payment that relates to the notice period (even if it is not worked or only worked in part) is worked out first and anything remaining will be a termination payment. This means the £24,000 PILON will be taxed and subject to Class 1 as it relates to her notice period. The £40,000 compensation for loss of office will fall under the termination payment rules; the first £30,000 of the payment will be free from both tax and NICs, leaving £10,000 that will be taxed and subject to employer's NICs.

Example 2		Rules up to April 2018			Rules from April 2018		
Total payment	£64,000	Income tax	EE NICs	ER NICs	Income tax	EE NICs	ER NICs
PILON	£24,000	Earnings (Yes)	Earnings (Yes)	Earnings (Yes)	Earnings (Yes)	Earnings (Yes)	Earnings (Yes)
Termination payment (less tax-free £30,000)	£10,000	TP (Yes)	TP (No)	TP (No)	TP (Yes)	TP (No)	TP (Yes)

If the contract does not refer to a PILON and only specified a minimum notice period, the amount that the employee would have received, had they worked their notice period, will be subject to tax and NICs as earnings.

Example 3: This example demonstrates the impact of the rule changes for benefits in kind, which will take effect from April 2018.

An employee is told to leave their job immediately without working their notice period. They are asked to hand back their company car and will no longer be able to use the workplace gym. The employment contract allows for a minimum six month notice period only.

The employee is entitled to:

- gross salary of £50,000 per year;
- a company car with an annual benefit in kind value of £6,000; and
- a workplace gym membership.

The employment is terminated immediately and the employee receives:

- £25,000 PILON (which is not included in the employment contract); and
- £50,000 compensation for loss of office which includes compensation for no longer having access to the car and the workplace gym.

As before, the payment the individual would have received, had they worked their notice period, should be worked out first. In this case, it will include the £25,000 PILON and the cash value of any benefits in kind. The value cash equivalent of a company car is calculated on a pro rata basis and so the cash equivalent would be £3,000 because the employee was entitled to use it for the next 6 months.

The workplace gym membership is an exempt benefit. This means no tax or NICs is due and so it would be valued at £0.

This means that employee would have received £28,000 if they had worked their notice period. This will all be subject to tax and Class 1 NICs.

The remaining payment of £47,000 relates to compensation for loss of office and the workplace gym membership which will fall under the termination payment rules. The first £30,000 of the payment will be free from both tax and NICs, leaving £17,000 that will be taxed and subject to employer's NICs.

Example 3		Rules up to April 2018			Rules from April 2018		
Total payment	£75,000	Income tax	EE NICs	ER NICs	Income tax	EE NICs	ER NICs
PILON	£25,000	TP (Yes)	TP (No)	TP (No)	Earnings (Yes)	Earnings (Yes)	Earnings (Yes)
Compensation for car	£3,000	TP (Yes)	TP (No)	TP (No)	Earnings (Yes)	Earnings (No)	Earnings (Yes)
Termination payment (less tax-free £30,000)	£17,000	TP (Yes)	TP (No)	TP (No)	TP (Yes)	TP (No)	TP (Yes)

Explanation of the draft legislation

3. The draft legislation is intended to give a broad idea of the basis on which the new termination payments policy will work, but there is some detail that has not been included at this stage.
4. The changes are achieved through a number of amendments to the termination payment legislation in Chapter 3, Part 6 of the Income Tax (Earnings and Pensions) Act (ITEPA) 2003. The key changes to the treatment of post-employment income are achieved by inserting a number of new sections (402A-402E).
5. The legislation effectively splits an employee's termination payment into two types of payment: payments that can still benefit from the £30,000 threshold and those that cannot.

6. Section 402A sets out how payments and benefits-in-kind should be divided between the new rules in s402B and the current termination payments charge at s403. Priority is given to those payments that would have been earnings if the employee had worked through their notice period. The new legislation works by first identifying any payments that should be treated as earnings and any remainder is then subject to the £30,000 threshold.
7. The legislation specifically treats payments such as statutory redundancy or an unfair dismissal award as being subject to the £30,000 threshold.
8. Section 402B sets out the charge on payments or benefits that cannot benefit from the £30,000 threshold. The legislation treats the payment as “general earnings” so for tax purposes they are treated like salary or benefits-in-kind.
9. Section 402C sets out the definitions of “termination award”, “non-excluded termination award” and how to establish when post-employment notice income may be subject to the threshold.
10. Section 402D defines “post-employment notice income” and “expected bonus income”. It also provides how to calculate the post-employment notice income by reference to the amount of the employee’s general earnings from the employment for the 12 weeks ending with the “trigger point” multiplied by the number of days in the “default period”.
11. The aim of s402D is to treat the termination of any employment in a consistent way by treating the employee as having worked through their notice regardless of what actually happens. This section calculates an average value for the earnings of the employee during this period taking into account any salary, benefits-in-kind or bonuses that the employee would or should have received. It uses 12 weeks because it aims to cover employments which have irregular levels of income.
12. Section 402D(8) sets out an anti-avoidance rule to prevent artificial reductions in general earnings in anticipation of a termination.
13. Section 402E provides the meanings of “default period” and “trigger point”. The way the legislation works depends on the employee’s minimum notice and whether the employee works some, all or none of their minimum notice period.
14. A new power to vary the threshold is provided by inserting a new section 404B.
15. There are also sections that clarify the exemption for injured feelings and remove the Foreign Service Relief, maintaining the provision of relief for seafarers only.
16. We would welcome views on whether the draft legislation fulfils the policy objectives and any other comments you may have. Views on the following questions are of particular interest:

1. Is it appropriate to use a period of 12 weeks to calculate the cash and benefits element of the 'post-employment notice income'? Are there any circumstances where this could lead to unfair outcomes?
2. We have given bonus a wide meaning in this legislation. Is this appropriate?
3. We have used a wide interpretation of 'arrangements' in the anti-avoidance provision at s402D(9). Is this sufficient?
4. We are considering what other anti-avoidance provisions may be needed in the legislation. Are there other aspects of the policy might require anti-avoidance safeguards and how should these be targeted?
5. To comply with this draft legislation, are there any additional pieces of information that employers and payroll managers would need to identify beyond what they already have available?
6. Are there other aspects of the termination payments legislation that the government should address while we have this opportunity?

The consultation process: how to respond

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 3 of the process. The purpose of the consultation is to seek views on draft legislation in order to confirm, as far as possible, that it will achieve the intended policy effect with no unintended effects.

How to respond

Please send written submissions addressing the questions and issues raised in this consultation paper before 5 October 2016, by e-mail to employmentincome.policy@hmrc.gsi.gov.uk or by post to: Employment Income Policy Team

Room 1E/08
100 Parliament Street
London
SW1A 2BQ

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from [HMRC's GOV.UK pages](#). All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles. The Consultation Principles are available on the Cabinet Office website: <http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

John Pay, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.

Annex A: Draft legislation

1 Payments on termination of employment etc

- (1) ITEPA 2003 is amended in accordance with subsections (2) to (11).
- (2) In section 7(5) (list of provisions under which amounts are treated as earnings), before the “or” at the end of paragraph (c) insert—
 - “(ca) section 402B (termination payments, and other benefits, that cannot benefit from section 403 threshold),”.
- (3) Before section 403 (charge on payments and benefits in excess of £30,000 threshold) insert—

“402A Split of payments and other benefits between sections 402B and 403

- (1) Payments and other benefits to which this Chapter applies because of section 401(1)(a) (termination of employment) are, to the extent determined under section 402C, ones to which section 402B applies.
- (2) Payments and other benefits to which this Chapter applies because of section 401(1)(a) are ones to which section 403 applies so far as they are not ones to which section 402B applies.
- (3) Payments and other benefits to which this Chapter applies because of section 401(1)(b) or (c) (change in duties or earnings) are ones to which section 403 applies.

402B Amounts not benefiting from threshold to be treated as earnings

- (1) The amount of a payment or other benefit to which this section applies is treated as an amount of earnings of the employee, or former employee, from the employment.
- (2) See also section 7(3)(b) and (5)(ca) (which cause amounts treated as earnings under this section to be included in general earnings).
- (3) Section 403(3) (when benefits are received) does not apply in relation to payments or other benefits to which this section applies.

402C The payments and other benefits to which section 402B applies

- (1) In this section—

“termination award” means a payment or other benefit to which this Chapter applies because of section 401(1)(a), and

“non-excluded termination award” means a termination award that is none of the following—

- (a) an award of compensation for unfair dismissal under Part 10 of ERA 1996 or Part 11 of ER(NI)O 1996,
- (b) a redundancy payment, and
- (c) so much of an approved contractual payment as does not exceed the amount which would have been due if a redundancy payment had been payable.

(2) This section has effect for the purpose of identifying the extent to which section 402B applies to termination awards in respect of the termination of the employment of the employee.

(3) For the purposes of this section—

PB is the total of—

- (a) the post-employment notice income, and
- (b) the expected bonus income, and

T is the total amount of the non-excluded termination awards.

(4) See section 402D for the meaning of “post-employment notice income” and “expected bonus income”.

(5) If PB is greater than or equal to T, section 402B applies to all of the non-excluded termination awards in respect of the termination.

(6) If PB is less than T—

- (a) section 402B applies to a part of the non-excluded termination awards in respect of the termination, and
- (b) the amount of that part is equal to PB.

(7) Section 309(4) to (6) (meaning of “redundancy payment” and “approved contractual payment” etc) apply for the purposes of subsection (1) as they apply for the purposes of section 309.

402D “Post-employment notice income” and “expected bonus income”

(1) This section has effect for the purposes of section 402C(3).

(2) “The post-employment notice income” is (subject to subsection (8)) given by—

$$\frac{G \times D}{84}$$

where—

D is the number of days in the default period, and

G is the employee's general earnings from the employment for the 12 weeks ending with the trigger point that are not earnings by way of bonus.

- (3) If the period beginning with the start of the employment and ending with the trigger point is shorter than 12 weeks, subsection (2) has effect as if—
 - (a) the reference to 84 were a reference to the number of days in that shorter period, and
 - (b) the reference to the 12 weeks ending with the trigger point were a reference to that shorter period.
- (4) "The expected bonus income" is the total amount of any payments and other benefits within any of subsections (5) to (7).
- (5) A payment or other benefit is within this subsection if it is a payment or other benefit by way of bonus—
 - (a) that the employee could reasonably be expected to receive, by reference to the employment and in respect of times before the end of the employment, were the employee to continue in the employment long enough to receive it, and
 - (b) that has not been received before the employment ends.
- (6) A payment or other benefit is within this subsection if it is a payment or other benefit by way of bonus—
 - (a) that the employee could reasonably be expected to receive, by reference to the employment and in respect of times during the default period, were the employee to continue in the employment throughout the default period and long enough afterwards to receive it, and
 - (b) that has not been received before the employment ends.
- (7) A payment or other benefit is within this subsection if it is a payment or other benefit by way of bonus that—
 - (a) the employee could reasonably be expected to receive, at any time in the default period and by reference to the employment, were the employee to continue in the employment until the end of that period, and
 - (b) is not one identified under subsection (5) or (6).
- (8) Where the purpose, or any of the purposes, of any arrangements is to cause G in subsection (2) to be less than it would otherwise be, G is to be treated as given by—

- (a) identifying the three most recent tax years beginning before the trigger point,
 - (b) identifying, for each of the first two of those three years, the amount (which may be nil) of the employee's general earnings from the employment for the year that are not earnings by way of bonus,
 - (c) identifying, for the period beginning with the start of the third of those years and ending with the date of the trigger point, the amount (which may be nil) of the employee's general earnings from the employment for the period that are not earnings by way of bonus,
 - (d) multiplying each amount identified at paragraph (b) or (c) by 84, and then dividing each result by the number of days in the period—
 - (i) beginning with the start of the year concerned or, if the employment starts in that year, the date the employment starts, and
 - (ii) ending with the end of the year concerned or, if the trigger point is in that year, the date of the trigger point, and
 - (e) treating G as being the highest of the three amounts calculated at paragraph (d).
- (9) In subsection (8) “arrangements” includes any scheme, arrangement or understanding of any kind, whether or not legally enforceable, involving a single transaction or two or more transactions.
- (10) In this section “bonus” includes commission, incentive and anything similar.
- (11) For the meaning of “default period” and “trigger point” see section 402E.

402E Meaning of “default period” and “trigger point” in section 402D

- (1) Subsections (2), (4) and (5) have effect for the purposes of section 402D.
- (2) If the termination is not a notice case—
 - “the default period” is the period—
 - (a) beginning with the end of the employment, and
 - (b) equal in length to the minimum notice, and
 - “the trigger point” is the end of the employment.
- (3) If the termination is a notice case, for the purposes of this section “the worked notice” is the period—
 - (a) beginning with the giving of the notice, and
 - (b) ending with the end of the employment.

- (4) If the termination is a notice case and the worked notice is shorter than the minimum notice—
- “the default period” is the period—
- (a) beginning with the end of the employment, and
- (b) equal in length to the difference between the worked notice and the minimum notice, and
- “the trigger point” is the giving of the notice.
- (5) If—
- (a) the termination is a notice case, and
- (b) the worked notice is equal to, or longer than, the minimum notice, “the trigger point” is the giving of the notice, but the number of days in the default period is treated as being zero.
- (6) For the purposes of this section, the termination is a “notice case” if the employer or employee gives notice to the other to terminate the employment, and here it does not matter—
- (a) whether the notice is more or less than, or the same as, the minimum notice, or
- (b) if the employment ends before the notice expires.
- (7) For the purposes of this section, the “minimum notice” is the minimum notice required to be given by the employer to terminate the employee’s employment in accordance with the law and contractual terms effective—
- (a) where the termination is not a notice case, immediately before the employment ends, and
- (b) where the termination is a notice case, immediately before the notice is given.”
- (4) In section 403 (charges on payments and benefits which can benefit from threshold)—
- (a) in subsection (1), for “Chapter” substitute “section”,
- (b) in subsection (3), after “Chapter” insert “(but see section 402B(3))”,
- (c) in subsection (4), for the words from “when” to “exceeds” substitute “when aggregated with—
- (a) other payments or benefits in respect of the employee or former employee that are payments or benefits to which this section applies, and
- (b) other payments or benefits in respect of the employee or former employee that are payments or benefits—
- (i) received in the tax year 2017-18 or an earlier tax year, and

- (ii) to which this Chapter applied in the tax year of receipt, it exceeds”,
 - (d) in subsection (5)(a), for “Chapter” substitute “section”,
 - (e) in subsection (6), after “employment income” insert “or, as the case may be, in relation to whom section 402B(1) provides for an amount to be treated as an amount of earnings”, and
 - (f) in the heading, at the end insert “where threshold applies”.
- (5) In section 404 (how the threshold applies)—
- (a) in subsection (3)(b) (meaning of “termination or change date”), for “this Chapter” substitute “section 403”, and
 - (b) after subsection (5) insert—
 - “(6) In subsection (3)(b), the reference to a payment or other benefit to which section 403 applies includes a reference to a payment or other benefit—
 - (a) received in the tax year 2017-18 or an earlier tax year, and
 - (b) to which this Chapter applied in the tax year of receipt.”
- (6) After section 404A insert—
- “404B Power to vary threshold**
- (1) The Treasury may by regulations amend the listed provisions by substituting, for the amount for the time being mentioned in those provisions, a different amount.
 - (2) The listed provisions are—
 - subsections (1), (4) and (5) of section 403, and
 - subsections (1), (4) and (5) of section 404 and its heading.
 - (3) Regulations under this section may include transitional provision.
 - (4) A statutory instrument containing regulations under this section which reduce the mentioned amount may not be made unless a draft of it has been laid before, and approved by a resolution of, the House of Commons.”
- (7) In section 406 (exception in cases of death, injury or disability)—
- (a) the existing text becomes subsection (1), and
 - (b) after that subsection insert—
 - “(2) In subsection (1) “injury” does not include injured feelings unless they amount to a psychiatric injury or other recognised medical condition.”

- (8) In section 413 (exception in certain cases of foreign service)—
- (a) in subsection (2) omit “(2A),”,
 - (b) omit subsection (2A),
 - (c) in subsection (3)—
 - (i) omit “but before the tax year 2013-14”, and
 - (ii) omit paragraph (a), including the “or” at the end,
 - (d) omit subsections (3ZA) and (3A),
 - (e) in subsection (4) omit paragraph (a), including the “or” at the end,
 - (f) in subsection (5)—
 - (i) in paragraph (a), after “1974” insert “so far as relating to employment as a seafarer”,
 - (ii) in paragraph (b), after “1977” insert “so far as relating to employment as a seafarer”,
 - (iii) before the “or” at the end of paragraph (b) insert—
 - “(ba) section 193(1) of ICTA so far as relating to employment as a seafarer,”, and
 - (iv) in paragraph (c) omit “or 193(1)”,
 - (g) in subsection (6), after “1974-75” insert “in an employment as a seafarer”,
 - (h) after subsection (6) insert—
 - “(7) In this section “employment as a seafarer” is to be read in accordance with section 384.”, and
 - (i) in the heading, after “foreign service” insert “as seafarer”.
- (9) In section 414(2) (proportionate reduction for foreign service, as seafarer, in certain cases), for “otherwise count as employment income under this Chapter” substitute “otherwise—
- (a) be treated as earnings by section 402B(1), or
 - (b) count as employment income as a result of section 403”.
- (10) In section 415 (valuation of benefits), after subsection (7) insert—
- “(8) This section does not apply for the purposes of section 402D(2) or (8).”
- (11) In section 717(4) (regulations etc not subject to negative procedure), before “or section 681F(3)” insert “, section 404B(4) (reduction of tax-free threshold for employment-termination etc payments)”.
- (12) In consequence of amendments made by this section in section 413 of ITEPA

2003—

(a) in Schedule 7 to FA 2008, omit paragraph 30, and

(b) in Schedule 46 to FA 2013, omit paragraph 38.

(13) The amendments made by this section have effect for the tax year 2018-19 and subsequent tax years.

Annex B: List of consultation respondents

We are grateful to all those who took time to send written responses to the consultation, each of which has been taken into consideration in shaping the detail of the policy. Those who submitted written responses are shown below.

Aberdeen City Council
Arcadia Group
Aspen Insurance
Association of Accounting Technicians
Association of School and College Leaders
Association of Train Operating Companies
Aviva
Baptist Union of Great Britain
Barber Harrison and Platt
Bar Council
Barclays Bank
BDO LLP
Birketts LLP
Birmingham Law Society
Blake Morgan LLP
BOAL
Bray & Kraiss
British Airline Pilots Association
British Universities Finance Directors Group
BT
Burgess Salmon
Camlab
Caterpillar
CBI
Chartered Institute of Payroll Professionals
Chartered Institute of Taxation
Cisco
Citi
Civil Service Employee Policy
Deloitte LLP
EEF
ELAS
Employment Law in Action
Employment Lawyers Association
Ernst and Young LLP
Essex Police and Kent Police
Equality and Human Rights Commission
Ford Motor Company
Fox Williams LLP
G4S
GC100
Grant Thornton LLP (Leeds)
Grant Thornton LLP (London)

Hewlett-Packard
Hogan Lovell International LLP
IG
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants of Scotland
Irwin Mitchell LLP
KPMG LLP
Law Society
Leeds City Council
Legal and General
Leicestershire County Council
Lewis Silkin LLP
Liverpool City Council
Liverpool Law Society
Low Incomes Tax Reform Group
Mazars LLP
Ministry of Defence
NASUWT
National Association of Head Teachers
National Grid
National Trust
Nationwide Building Society
NSG
Open University
Outset Legal LLP
Payroll Alliance
PFP
Pinsent Masons LLP
Police Investigations and Review Commissioner
Prospect Trade Union
Pricewaterhouse Coopers LLP
Prudential
Refresco Gerber
Rolls-Royce
Royal Bank of Scotland
Royal Mail
Scottish Engineering
SEPA
Share Plan Lawyers
Simmons and Simmons LLP
Sky Group
Society of Pension Professionals
Sunderland College
SSE
Stoke-on-Trent City Council
Transport for London
Thomas Eggar LLP
Thompsons Solicitors
Trades Union Congress
Travers Smith LLP

UHY Hacker Young
Unionline
Unison
United Utilities
University of East Anglia
Weil, Gotshal and Manges
Yorkshire Dales National Park

and nine individuals.

Stakeholders who attended meetings

We are also grateful to those who took time to attend consultation meetings held during August and September 2015 to give their views on the policy and raise their concerns. Those who took part in these meetings are shown below.

Armstrong Watson
Association of Taxation Technicians
Aspen Insurance
BCS: Chartered Institute of IT
CBI
Chartered Institute of Payroll Professionals
Chartered Institute of Taxation
Cintra HR and Payroll Services
Citi
David Heaton Tax
Deloitte LLP
Equiniti
Ernst and Young LLP
Innovation LLP
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants of Scotland
Kate Upcraft Consultancy
KPMG LLP
Low Income Tax Reform Group
Midland HR
Nationwide Building Society
Office of Tax Simplification
Payroll Alliance
Prudential
QTac Solutions
Royal Mail
Shell International
Smith Williamson
Toyota
Wilkins Kennedy LLP
Zurich Insurance