

Explanatory Note: draft clause

Termination Payments: Removal of Foreign Service Relief for UK Residents

Summary

1. This clause removes foreign service relief on termination payments for UK residents. This will ensure that all employees who are UK resident in the tax year their employment is terminated will be liable to income tax on their termination payment in the same way regardless of whether they have worked abroad. Foreign service relief is retained for seafarers.

Details of the clause

2. Subsection (1) provides for amendments to the Income Tax (Earnings and Pensions) Act 2003.
3. Subsection (2) inserts a new subsection to section 413 of ITEPA (Exception in certain cases of foreign service) to set out that exceptions in the case of foreign service apply if the employee or former employee is non-UK resident in the tax year their employment is terminated. Exceptions in the case of foreign service continues to apply to payments and benefits in connection with a change in the duties of a person's employment or a change in the earnings from a person's employment where the employee is UK resident.
4. Subsection (3) inserts a subsection in section 414 of ITEPA (Reduction in other cases of foreign service) setting out that deductions in the case of foreign service relief apply if the employee or former employee is non-UK resident in the tax year their employment is terminated. Reductions in the case of foreign service continues to apply to payments and benefits in connection with a change in the duties of a person's employment or a change in the earnings from a person's employment where the employee is UK resident.
5. Subsection (4) inserts new section 414B ITEPA (Exception in certain cases of foreign service as seafarer) and new section 414C (Reduction in other cases of foreign service as seafarer).

New Section 414B ITEPA 2003

6. New subsection 414B(1) sets out new section 414B applies to payments or benefits arising upon the termination of employment where the employee or former employee is UK resident in the tax year in which the employment terminates.
7. New subsection 414B(2) sets out that the reduction for service relief will in future only apply to foreign seafaring service.

8. New subsections 414B(3) to (7) define foreign seafaring service, by applying the tax years in service as a seafarer.
9. New subsections 414B(8) cross refers to section 384 ITEPA, which defines the meaning of employment as a seafarer.

New Section 414C ITEPA 2003

10. New subsection 414C(1) sets out that new section 414C, reductions in cases of foreign service as a seafarer, applies to foreign service seafarers who are not excluded by section 414B.
11. New subsection 414C(2) sets out the conditions for when a reduction for foreign service for seafarers can be claimed.
12. New subsection 414C(3) sets out that the proportionate reduction will be calculated by reference to the length of the foreign seafaring service as a proportion of the length of service in the whole employment.
13. New subsection 414C(4) to (5) set out the limits of entitlement to foreign service, where a person is entitled to deduct, retain, satisfy income tax out of a payment which the person is liable to make or charge income tax against another person.
14. New subsection (6) provides that "foreign seafaring service" has the same meaning in Section 414C as in Section 414B(2).
15. Subsection (5) sets out that that these changes have effect from, on or after 6 April 2018 and, if the termination payment is received after 13 September 2017.

Background note

16. The government believes income tax relief for foreign service has become outdated and unnecessary. In August 2016, HMRC published draft legislation for technical consultation on changes to the taxation of termination payments as a whole, including the removal of foreign service relief. The consultation highlighted territorial issues with the legislation relating to foreign service.
17. The government therefore announced at Budget 2017 that it would withdraw the original proposal in order to reconsider and bring forward new legislation ready for implementation from April 2018.
18. Those who have worked abroad but are resident in the UK in the year their employment is terminated will be taxed in the same way as others who have not worked abroad. They will continue to benefit from the existing £30,000 income tax exemption and an unlimited employee National Insurance contributions (NICs) exemption for payments associated with the termination of employment.
19. Reductions in the case of foreign service (sometimes referred to as 'foreign service exemption') is retained for seafarers.
20. If you have any questions about this change, or comments on the legislation, please contact Paul Phillips on 03000 586521 (email: paul.phillips1@hmrc.gsi.gov.uk).