

Clause 1: Payments on termination of employment

Summary

1. This clause amends the income tax treatment of termination payments in two ways. The clause provides a new calculation for Post-Employment Notice Pay (PENP) for employees paid by equal monthly instalments whose post-employment notice period is not a whole number of months. The clause also brings PENP within the charge to UK tax for individuals who are non-resident in the year of termination of their UK employment. The clause will take effect from 6 April 2021. The clause will apply to those individuals who both have their employment terminated and receive a termination payment on or after 6 April 2021.

Details of the clause

2. Subsection 1 amends section 27 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) (UK-based earnings for year when employee not resident in UK) in accordance with subsections (2) to (5).
3. Subsection 2 inserts new paragraph (c) into subsection 27(1) of ITEPA to include 'general earnings to which section 402B ITEPA 2003 applies'. Section 402B treats PENP as earnings; this amendment brings those earnings within the scope of section 27 with the effect that those earnings are 'taxable earnings'.
4. Subsection 3 amends subsection 27(2) of ITEPA to provide that it only applies to existing subsections 27(1)(a) and (b). The new subsection 2A will have effect in relation to the new subsection 27(1)(c).
5. Subsection 4 inserts new subsection 2A into section 27 of ITEPA. New subsection 2A provides that the amount of general earnings which fall within subsection 27(1)(c) of ITEPA, that is to be considered an amount of "taxable earnings" should be calculated in accordance with the amount of general earnings that would have constituted "taxable earnings" within the scope of section 27 (1) (a) or (b) of ITEPA; had the employee worked during their notice period.
6. Subsection 5 amends subsection 27(3) of ITEPA to ensure that the tax charge imposed by new subsection 2A applies whether or not the employment is held when the earnings are received.
7. Subsection 6 amends section 402B(1) of ITEPA to clarify that PENP earnings are not subject to subsections 27(1)(a) or (b). This prevents the same amount of PENP from being considered as "taxable earnings" within the scope of both subsection 27(c) and subsection 27(a) or (b) of ITEPA, which may result in an excessive charge to tax.

8. Subsection 7 amends section 402D of ITEPA (“post-employment notice pay”).
9. Subsection 7(a) provides that the definitions at subsection 402D(3) of ITEPA are also subject to the new subsection 6A of section 402D of ITEPA.
10. Subsection 7(b) amends subsection 402D(6) of ITEPA to provide that it should only apply where the employee’s basic pay is paid in equal monthly instalments. Where the employee’s basic pay is not paid in equal monthly instalments subsection 402D(6) of ITEPA will not apply, to account for variations in the amount of pay resulting from the number of days in the last pay period.
11. Subsection 7(c) inserts new subsection 6A into section 402D of ITEPA. New subsection 6A provides for an alternative PENP calculation for certain employees. Where the employee’s last pay period before the trigger date is a month, the employee is paid in equal monthly instalments, and the notice period or post-employment notice period is not a whole month, new subsection (6A) provides that instead of using the number of days in that pay period, 30.42 (being the mean average number of days in a month) can be used as ‘P’ in the PENP calculation. This ensures that PENP does not vary according to the number of days in the monthly pay period preceding the trigger date where the remuneration for that period would not have so varied.
12. Subsection 8 provides that the amendments made by this clause will have effect for termination payments that are received on or after 6 April 2021 and in connection with an employment that is terminated on or after that date.

Background note

13. Changes were made to the taxation of termination payments in the Finance (No.2) Act 2017, with effect from 6 April 2018. This included the introduction of PENP to ensure that all contractual, customary and non-contractual payments in lieu of notice are subject to income tax and National Insurance Contributions as earnings consistently.
14. This clause is intended to improve the fairness and clarity of the PENP legislation by removing two known inconsistencies in the tax treatment of PENP.
15. Since October 2019, HM Revenue and Customs has exercised managerial discretion available under the Commissioners for Revenue and Customs Act 2005 to provide for an alternative calculation for PENP for use where the known inconsistency arises, and the alternative calculation is advantageous to the employee. This will continue to apply until 6 April 2021.
16. If you have any questions about this change, or comments on the legislation, please contact the HMRC Income Tax team at incometax.structure@hmrc.gov.uk.