Legislation update:

National Insurance Contributions on termination payments

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In some circumstances, employers may have to make termination payments to employees when their employment comes to an end. Termination payments are used in matters relating to settlement agreement, capability, conduct and redundancy. Where employment termination payments are identified 'as earnings', these termination payments are subject to normal tax and National Insurance Contributions (NICs). These payments are commonly referred to as payments *in lieu of notice* (PILONs) or post-employment notice pay (PENP), when communicating with HMRC. With other termination payments that are

otherwise known as settlement payments or redundancy payments there are new rules NICs that must be followed.

'Although the employer NICs treatment of termination payments will change on 1 April 2020, the existing employee Class 1 NICs exemption will be retained'

In April 2018, changes were introduced to all PILONs to be both taxable and subject to Class 1 National Insurance Contributions (NICs). The legislation requires the employer to identify the amount of basic pay that the employee would have received if they had worked their notice period. PILON is a payment made to an employee when employment is terminated without notice, instead of the employee working through a notice period and receiving pay in the normal way.

The changes were introduced to bring clarity for employers to the taxation of termination payments by making it clear that all PILONs, rather than previously just contractual PILONs, are taxable earnings. All employees will pay tax and Class 1 NICs on the amount of basic pay that

they would have received if they had worked their notice in full, even if they are not paid a contractual PILON. This means the tax and NICs consequences are the same for everyone and it is no longer dependent on how the employment contract is drafted. The PILON amount will be treated 'as earnings' and will not be subject to the £30,000 Income Tax exemption for other termination payments such as redundancy pay.

The last remaining measures for termination payments commonly relating to settlement pay and redundancy pay had been delayed in 2018. These changes were originally drafted in the National Insurance Contributions Bill published in 2016. Previously employers were not required to pay 1A NICs to payments 'in excess of £30,000 threshold'. However, from 1 April 2020 this payment will now be subject to class 1A National Insurance contributions, as an 'employer liability only'. An employer will be required to pay NICs on any part of a termination payment that exceeds the £30,000 threshold and collected in 'real-time', as part of the employer's standard payroll to HM Revenue and Customs (HMRC).

Although the employer NICs treatment of termination payments will change on 1 April 2020, the existing employee Class 1 NICs exemption will be retained for these types of termination payments even if the payment exceeds £30,000.

Furthermore, the existing £30,000 Income Tax exemption will also be retained for these payments associated with the termination of employment.

The new employer NICs rule doesn't need updating in these advice notes nor does any elements relating to other termination payments such as PILON. ♦

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