

Getting terminations right for mobile employees.








Chris Brookes **and** Steve Young

Global Employer Services Turn It Up

Deloitte.



Contents

- 1  **Inbound Scenario**
- 2  **Outbound Scenario**
- 3  **Treaty Considerations**
- 4  **Sourcing Summary**
- 5  **Employer Reporting- PAYE**
- 6  **Employer Reporting- NIC**
- 7  **Common Pitfalls**



Inbound Scenario: UK Domestic Treatment – William

- William is an Australian national and domicile and was an employee of Alpha Pty Ltd. He arrived in the UK 1 March 2021 on a 2-year assignment and had 20% OWD as part of his role. He first worked for Alpha Pty Ltd 28 February 2013. William is gross paid and has a s690 direction for 80% of his earnings to be liable to PAYE.
- Effective 28 February 2023, his assignment (and underlying employment with Alpha Pty Ltd) was terminated, without notice. William left the UK (and returned to Australia) 15 March 2023.
- William was provided with a compromise agreement, under which the following items were payable in March 2023:
 - £12k – accrued holiday pay;
 - A £90k PILON in relation to his unworked 6-month notice period;
 - A £20k restrictive covenant payment preventing William for working for a competitor in 2023;
 - A £100k ex-gratia payment;
 - £15k pro-rated 2023 bonus (ordinarily payable March 2024) and £35k in relation to lapsed share awards;

1

What are the considerations for each component of the package and how would we expect each to be taxed/ sourced under UK domestic law?

2

To what extent should these payments be subject to UK PAYE and National Insurance?

3

To what extent would the taxability, PAYE and NIC position be different if William's assignment ended 28 February, and he returned to Australia to work until his employment was terminated 15 April 2023?

Inbound Scenario: UK Domestic Treatment – William

- William is an Australian national and domicile and was an employee of Alpha Pty Ltd. He arrived in the UK 1 March 2021 on a 2-year assignment and had 20% OWD as part of his role. He first worked for Alpha Pty Ltd 28 February 2013. Effective 28 February 2023, his assignment (and underlying employment with Alpha Pty Ltd) was terminated, without notice. William left the UK (and returned to Australia) 15 March 2023.
- William was provided with a compromise agreement, under which various items are payable.

1

What are the considerations for each component of the package and how would we expect each to be taxed/ sourced under UK domestic law?

Accrued holiday pay

- Payment triggered by termination but earned over period entitlement arose;
- Will depend on holiday year(s) over which accrued – earnings ‘for’ this period and so based on this period’s taxability/ working pattern;

PILON for 6-month notice period

- If contractual, this would be considered earnings ‘for’ part of the year in which employment ended – i.e. taxable in the UK with overseas workday relief based on 6 April to 28 February workday pattern;
- If non-contractual, the PILON is likely to be caught under Post Employment Notice Pay rules and would also be taxable in the UK in these circumstances, subject to overseas workday relief, based on the workdays from 6 April to 28 February.

Restrictive covenant payment

- Treated as earnings for the tax year in which payment is paid;
- If employment not held in that year, it is treated as earnings for the last year of employment;
- In this case, the payment would be taxable in the UK with overseas workday relief based on 6 April to 28 February workday pattern.

Inbound Scenario: UK Domestic Treatment – William – Poll 1

- William is an Australian national and domicile and was an employee of Alpha Pty Ltd. He arrived in the UK 1 March 2021 on a 2-year assignment and had 20% OWD as part of his role. He first worked for Alpha Pty Ltd 28 February 2013. Effective 28 February 2023, his assignment (and underlying employment with Alpha Pty Ltd) was terminated, without notice. William left the UK (and returned to Australia) 15 March 2023.
- William was provided with a compromise agreement, under which various items are payable.

Would William's ex gratia payment qualify for Foreign Service Relief (FSR)?

A

Yes – full FSR

B

Yes – partial FSR

C

No FSR

Inbound Scenario: UK Domestic Treatment – William

- William is an Australian national and domicile and was an employee of Alpha Pty Ltd. He arrived in the UK 1 March 2021 on a 2-year assignment and had 20% OWD as part of his role. He first worked for Alpha Pty Ltd 28 February 2013. Effective 28 February 2023, his assignment (and underlying employment with Alpha Pty Ltd) was terminated, without notice. William left the UK (and returned to Australia) 15 March 2023.
- William was provided with a compromise agreement, under which various items are payable.

1

What are the considerations for each component of the package and how would we expect each to be taxed/ sourced under UK domestic law?

Ex-gratia payment

- If there is genuinely no existing entitlement to the payment/ it's not classed as earnings, it would be a s401 payment, taxable to the extent it exceeds £30,000;
- Foreign Service Relief (FSR) is only available where the taxpayer is full year non-UK resident for the tax year in which the employment ends- William will be partly resident for the 2022/23 UK tax year, so no FSR will apply.

Pro-rated 2023 bonus and payment for lapsed share awards

- We need to consider if earnings (normal sourcing provisions based on earnings period to date employment ends), or s401 compensation – although HMRC assumption will be that payments are made under the incentive plan, and the onus is on us to prove they are not;
- If paid in accordance with the plan (good leaver provisions) or there is an expectation of payment in the circumstances, likely seen as earnings;
- If paid in accordance with plan entitlements, or in the same form (e.g. shares), then likely viewed as earnings/ or taxable under Part 7 (normal share option/ RSU rules).

Inbound Scenario: UK Domestic Treatment – William – Poll 2

- William is an Australian national and domicile and was an employee of Alpha Pty Ltd. He arrived in the UK 1 March 2021 on a 2-year assignment and had 20% OWD as part of his role. He first worked for Alpha Pty Ltd 28 February 2013. Effective 28 February 2023, his assignment (and underlying employment with Alpha Pty Ltd) was terminated, without notice. William left the UK (and returned to Australia) 15 March 2023.
- William was provided with a compromise agreement, under which various items are payable.

To what extent would PAYE apply to the termination payments?

A

In full

B

80% - reflecting the
s690

C

Not subject to PAYE

Inbound Scenario: UK Domestic Treatment – William

- William is an Australian national and domicile and was an employee of Alpha Pty Ltd. He arrived in the UK 1 March 2021 on a 2-year assignment and had 20% OWD as part of his role. He first worked for Alpha Pty Ltd 28 February 2013. Effective 28 February 2023, his assignment (and underlying employment with Alpha Pty Ltd) was terminated, without notice. William left the UK (and returned to Australia) 15 March 2023.
- William was provided with a compromise agreement, under which various items are payable.

2

To what extent should these payments be subject to UK PAYE and National Insurance?

- PAYE applies where the taxpayer is 'employed by, paid by or working for' a UK employer at the date of termination, and as William is on assignment until the date of termination, PAYE would apply;
- The s690 direction applies to payments made in the 2022/23 tax year, so applies to payments made post termination and would also apply to s401 payments- as specifically confirmed in HMRC manual at PAYE81545.
- PAYE would effectively apply to 80% of all payments, including 80% of the amount of the ex gratia payment in excess of £30k, with PAYE calculated on a OT M1 basis.
- For NIC purposes, William would be subject to NIC at the date of termination because he was working in the UK and therefore gainfully employed at the point of termination, and his assignment from Australia had exceeded the 52 week exemption by this point.
- Class 1 (both employee and employer) NIC is due on the holiday pay, PILON, restrictive convenient and pro-rated 2023 bonus.
- For the lapsed share awards, on the basis these are a Chapter 5 scheme, then Class 1 (both employee and employer) NIC is due on the portion of the award that was subject to NIC during the relevant period.
- Class 1A NIC (employer NIC only) would be payable on the amount of the ex-gratia payment exceeding £30k.

Inbound Scenario: UK Domestic Treatment – William – Poll 3

- William is an Australian national and domicile and was an employee of Alpha Pty Ltd. He arrived in the UK 1 March 2021 on a 2-year assignment and had 20% OWD as part of his role. He first worked for Alpha Pty Ltd 28 February 2013. Effective 28 February 2023, his assignment (and underlying employment with Alpha Pty Ltd) was terminated, without notice. William left the UK (and returned to Australia) 15 March 2023.
- William was provided with a compromise agreement, under which various items are payable.

Would the payments be liable to employee NIC if William's assignment ended 28 Feb but he returned to work in Australia and was terminated on 15 April?

A

NICable in full

B

NICable other than s401 payments

C

**Not subject to
NIC**

Inbound Scenario: UK Domestic Treatment – William

- William is an Australian national and domicile and was an employee of Alpha Pty Ltd. He arrived in the UK 1 March 2021 on a 2-year assignment and had 20% OWD as part of his role. He first worked for Alpha Pty Ltd 28 February 2013. Effective 28 February 2023, his assignment (and underlying employment with Alpha Pty Ltd) was terminated, without notice. William left the UK (and returned to Australia) 15 March 2023.
- William was provided with a compromise agreement, under which various items are payable.

3

To what extent would the taxability, PAYE and NIC position be different if Williams's assignment ended 28 February, and he returned to Australia to work until his employment was terminated 15 April 2023?

- In these circumstances, the employment would end in 2023/24 (a tax year of non-residence), and William should qualify for full Foreign Service Relief (75%+ foreign service), so the ex gratia payment would be fully exempt from UK tax.
- William would also not be 'working for' a UK employer at the date of termination, so PAYE would not apply to termination payments specifically (although an obligation may still exist on any incentive payments). Any taxable termination payments would be reportable via William's UK tax return.
- For NIC purposes, on the basis that William returned to Australia and performed duties for his overseas employment in Australia before termination, then he would be outside the scope of NIC at the point of termination. He would have therefore ceased to be a 'employed earner' for NIC purposes at this point. Accordingly, there is no NIC payable in respect of nearly all the elements from the compromise agreement
- However, if the lapsed share awards were granted under a Chapter 5 scheme, then Class 1 (both employee and employer) NIC is due on the portion of the award that was subject to NIC during the relevant period. Alternatively, if this is a s62 scheme, then no NIC would be due.
- Note: Care does need to be taken to ensure that William has ceased to be an 'employed earner' for NIC purposes at point of termination. If no work duties performed in Australia (eg on gardening leave) following repatriation, then arguably because he was subject to NIC in respect of employment performed in the UK then compromise agreement would fall within scope of NIC.

Outbound Scenario: UK Domestic Treatment – Shreena

- Shreena, 45, is a UK national and an employee of XYZ in France – a company within the XYZ plc group. She began working for XYZ plc (in the UK) 1 April 2008, before transferring 31 March 2014 to XYZ in Spain, then Germany and then France.
- Effective 30 September 2022, Shreena is placed on 6 months garden leave and her employment with XYZ in France terminates 31 March 2023, by reason of redundancy due to a restructuring of the marketing function within the group.
- During her garden leave period, Shreena returns to the UK (splits the tax year from 1 January 2023- i.e. taxed as a resident from that date).
- As part of her termination package, Shreena receives the following payments, paid by XYZ in France:
 - £10k per month garden leave (paid monthly October 22 to March 23);
 - An £80k statutory payment due automatically under French employment law due to termination by reason of redundancy, paid 30 April 23;
 - A £120k 'ex-gratia' severance payment, paid 30 April 23.

1

What are the considerations for each component of the package and how would we expect each to be taxed/ source under UK domestic law?

2

To what extent would these payments be subject to PAYE?

3

To what extent would these payments be subject to UK National Insurance?

Outbound Scenario: UK Domestic Treatment – Shreena

- Shreena, 45, is a UK national and an employee of XYZ in France – a company within the XYZ plc group. She began working for XYZ plc (in the UK) 1 April 2008, before transferring 31 March 2014 to XYZ in Spain, then Germany and then France.
- Effective 30 September 2022, Shreena is placed on 6 months garden leave and her employment with XYZ in France terminates 31 March 2023, by reason of redundancy due to a restructuring of the marketing function within the group.
- During her garden leave period, Shreena returns to the UK (splits the tax year from 1 January 2023- i.e. taxed as a resident from that date).
- As part of her termination package, Shreena receives various payments, paid by XYZ in France.

1

What are the considerations for each component of the package and how would we expect each to be taxed/ source under UK domestic law?

Garden leave (Oct 22 to March 23)

- Garden leave is tax as salary 'for' the relevant months to which it relates. Whereas Shreena would ordinarily have worked in France, payments related to a period when she's UK resident would be taxable in the UK- so the January to March 2023 garden leave would be taxable in full in the UK;
- If these payments are also subject to tax in France, to the extent Shreena would have been working in France, a Foreign Tax Credit should be available in the UK

Outbound Scenario: UK Domestic Treatment – Shreena

- Shreena, 45, is a UK national and an employee of XYZ in France – a company within the XYZ plc group. She began working for XYZ plc (in the UK) 1 April 2008, before transferring 31 March 2014 to XYZ in Spain, then Germany and then France.
- Effective 30 September 2022, Shreena is placed on 6 months garden leave and her employment with XYZ in France terminates 31 March 2023, by reason of redundancy due to a restructuring of the marketing function within the group.
- During her garden leave period, Shreena returns to the UK (splits the tax year from 1 January 2023- i.e. taxed as a resident from that date).
- As part of her termination package, Shreena receives various payments, paid by XYZ in France.

1

What are the considerations for each component of the package and how would we expect each to be taxed/ source under UK domestic law?

Statutory payment due under French law on termination

- Although automatically due, on the basis that Shreena is being made redundant, the payment should be taxable under s401;
- The payment would be subject to the £30k exemption, but Foreign Service Relief (FSR) would not be available as Shreena is partly resident for the 2022/23 tax year;
- If FSR had been available, we'd need to consider if this payment is solely French service period relevant under French law;
- HMRC is likely to challenge s401 treatment where French law would also allow for payment in 'non-redundancy' cases- i.e. if this amount would be received generally as a 'good leaver'.

Ex-gratia Severance Payment

- If no entitlement/ not classed as earnings, s401 payment and taxable to extent exceeds £30k;
- As she's partly resident for the 2022/23 tax year, Shreena would not be eligible for FSR.

Outbound Scenario: UK Domestic Treatment – Shreena - Poll

- Shreena, 45, is a UK national and an employee of XYZ in France – a company within the XYZ plc group. She began working for XYZ plc (in the UK) 1 April 2008, before transferring 31 March 2014 to XYZ in Spain, then Germany and then France.
- Effective 30 September 2022, Shreena is placed on 6 months garden leave and her employment with XYZ in France terminates 31 March 2023, by reason of redundancy due to a restructuring of the marketing function within the group.
- During her garden leave period, Shreena returns to the UK (splits the tax year from 1 January 2023- i.e. taxed as a resident from that date).
- As part of her termination package, Shreena receives various payments, paid by XYZ in France.

Would the garden leave payments from January 2023 be liable to PAYE and NIC?

A Yes - both

B PAYE but not NIC

C NIC but not PAYE

D No, neither

Outbound Scenario: UK Domestic Treatment – Shreena

- Shreena, 45, is a UK national and an employee of XYZ in France – a company within the XYZ plc group. She began working for XYZ plc (in the UK) 1 April 2008, before transferring 31 March 2014 to XYZ in Spain, then Germany and then France.
- Effective 30 September 2022, Shreena is placed on 6 months garden leave and her employment with XYZ in France terminates 31 March 2023, by reason of redundancy due to a restructuring of the marketing function within the group.
- During her garden leave period, Shreena returns to the UK (splits the tax year from 1 January 2023- i.e. taxed as a resident from that date).
- As part of her termination package, Shreena receives various payments, paid by XYZ in France.

2

To what extent would these payments be subject to PAYE?

- Even if amounts are UK taxable, if Shreena is not employed by, paid by or working for XYZ plc at the point of termination, there should be no PAYE obligation;
- Shreena should report any taxable amounts on her UK tax return and she may need to budget for a significant UK tax return balancing payment and then consider whether she can reduce any Payments on Account which are triggered as a result.

3

To what extent would these payments be subject to UK National Insurance?

- Despite returning to the UK, and potentially being within the scope of NIC, because Shreena is on garden leave then she should not be 'gainfully employed' in the UK (because this requires work to be physically performed in the UK). Shreena is therefore not an employed earner for NIC purposes, and all elements of her termination package should be outside the scope of NIC. As back-up to this position, there is EU guidance which indicates a termination payment is subject to social security in the country in which the employment was performed (France in this case).
- However, it's recommended that XYZ retain evidence that if Shreena is required to perform any work during this garden leave period that she would be required to return to her normal place of work (ie France).

DTA Considerations: Employment Income Article

Resident State

The State in which the individual is resident and treaty resident

Our UK view is this test usually applies at the date of payment not termination

The Resident State can tax the full amount of any TPs in accordance with its domestic law

The resident state takes relief for tax paid in the source state

Source State

OECD guidance provides guidance on the extent to which termination payments (TPs) are derived from employment in a Source State.

BUT the Source State retains the right to tax TPs to the extent they are **derived from duties physically performed in the Source State**

Remember, treaties don't create tax charges that don't exist under domestic law

Types of termination payments - summary

Payment type	UK domestic sourcing	Treaty sourcing for non-resident state at date of payment [Treaty resident state takes an FTC]
S401	Deduct £30,000. FSR available if full year non-resident in tax year of termination	Last 12 months of service (although HMRC have suggested this could be seen as compensation for loss of future earnings- i.e. where would they work over the next 12 months)
Contractual PILON	(Relevant part of) the tax year of termination.	Last 12 months of service
Non-contractual PILON / PENP	Taxed in full subject to any FSR available, or overseas workday relief if resident.	Last 12 months of service
Gardening leave	Treat as absence and source to where would have worked under s38 ITEPA 2003	Last 12 months of service
Accrued holiday	Source to period accrued over (where known)	Period accrued over (last 12 months may be practical position)
Restrictive covenants	Earnings for the (relevant part of) tax year of payment. If no earnings treat as earnings for (relevant part of) last year employment held	Taxed only in country of treaty residence at payment

Termination Payments- Employer Reporting- PAYE

?

What is the trigger, with a group employment, for PAYE to be operated?

- A PAYE obligation applies for an individual employed by, paid by or working for a UK employer – and this is tested at the point of termination.
- Termination payments are ‘for’ the year of termination, so this is different from PAYE obligations which would remain on trailing bonus or share payments.

?

At what rate should PAYE be calculated? What happens if the employee was previously on an NT code?

- Payments before the P45 is issued should be subject to PAYE based on the relevant tax code in the normal way.
- Payments after the P45 should be subject to PAYE on a OT M1 basis.
- Once the employment has terminated, the NT code also lapses so post-P45, OT withholding should ordinarily be applied even where an NT code was in place previously, but in practice HMRC do not object where the NT code was in place when the employment ended and the amounts delivered afterwards are not taxable at all in the UK.

?

Is clearance needed for FSR and/ or treaty relief for PAYE purposes?

- If full FSR applies, exempt amounts are not employment income and therefore not subject to PAYE, but would need to be sure that full FSR applied.
- Otherwise, treaty relief and partial FSR are a claim and clearance should strictly be obtained. We understand that HMRC’s view is that if the claim is valid, there is no issue, but if the claim is applied incorrectly, a PAYE failure will have arisen.
- The FSR clearance process can be quite onerous and there is no standard mechanism for treaty relief clearance.

Termination Payments- Employer Reporting- NIC

The Employer reporting obligations for NIC purposes in relation to termination payments changed in April 2020.

1

Changes in April 2020

Prior to April 2020 – qualifying termination payments were not ‘earnings’ for NIC purposes, and therefore any payment qualifying under s401 was exempt from NIC.

As such, before April 2020, NIC was only applicable to contractual payments eg PILON, accrued holiday etc.

Effective from 6 April 2020, Class 1A NIC is due on amounts from qualifying termination payments in excess of £30,000.

Contractual payments & Post Employment Notice Pay (PENP) remain subject to Class 1 NIC.

2

Is NIC due?

An employer NIC charge only arises where the employee concerned is within the scope of NIC for the payment concerned.

Accordingly, if the employee is covered by an A1/CoC/52 week exemption at the point of termination then no NIC is due.

However, care should be taken where termination payment relates to an ‘employed earners employment’ – ie an employment that is/was subject to NIC.

3

When is NIC paid?

Any Class 1 or 1A NIC due should be paid to HMRC by the normal RTI deadline for the pay period concerned ie if paid monthly then by 22nd of month following termination.

Note – Class 1A on termination payments is not declared via P11D(b) process and paid after year-end.

Types of termination payments - summary

“
Statutory Payment
under Foreign
Employment Law
”

“
Documents silent
on redundancy/
head count
reduction
”

“
Compromise
Agreement but
existing good
leaver/ contractual
entitlements
”

“
Executive
Severance Plans
”



This publication has been written in general terms and we recommend that you obtain professional advice before acting or refraining from action on any of the contents of this publication. Deloitte LLP accepts no liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NSE LLP do not provide services to clients. Please [click here](#) to learn more about our global network of member firms.

© 2023 Deloitte LLP. All rights reserved.

Designed by CoRe Creative Services. RITM1289854