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GMS Flash Alert

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United Kingdom - Autumn Budget Released, Termination Payment Changes Confirmed

The Autumn Budget, announced by the U.K. Chancellor of the Exchequer on 22 November 2017, was the first Budget of the current government following the election in June.[1] There were plenty of announcements, but these were largely around Corporation Tax and Value Added Tax. The Budget was fairly light in terms of content affecting global mobility.

The focus of tax policy remains at closing the "tax gap," which is the difference between what the U.K. government believes it should collect and what is actually collected. Tackling "Tax Avoidance and Evasion" remains at the heart of the U.K. government's tax strategy with the aim of collecting an additional £4.8 billion by 2022/23.

For coverage of last year's budget, see GMS *Flash Alert* 2016-139 (23 November 2016).

WHY THIS MATTERS

For employers of globally mobile employees there is always a great deal of interest in the Budget measures as they can have a direct impact on the cost of assignments. Over recent years there have been significant changes including restrictions of tax relief for pension contributions, changes to the treatment of payments from foreign pension plans and the taxation of non-domiciled individuals. Whilst there were no major changes announced this time round, the treatment of termination payments will change from 6 April 2018, and the final position is set out below.

Overview of the Main Measures

Abolition of Foreign Service Relief (FSR) on Termination Payments from 6 April 2018 Confirmed

The government published draft legislation in September 2017 for consultation to remove FSR in cases where an employee is U.K. tax resident in the tax year that his/her employment is terminated. This change does not extend to seafarers for whom the position on FSR will essentially remain unchanged.

It has now been confirmed that the draft legislation will not be amended prior to its introduction on 6 April 2018. This is in addition to the other proposed changes on termination payments which align the tax and employer's (but not employee's) National Insurance Contributions (NICs) position for payments above £30,000 and provide for non-contractual payments in lieu of notice to be subject to tax/NICs as if they were regular earnings. However, the change to employer's NICs will not take effect until 6 April 2019, as the government has deferred this aspect for one year because the NICs Bill will include other measures on which it wishes to consult further (see below on the abolition of Class 2 NICs).

FSR is a relief that recognises overseas service through the course of an employment. If the overseas service is significant, then full exemption from tax is available. Where the thresholds are not met, partial relief on a "time apportioned" basis can be claimed.

KPMG NOTE

HMRC says that FSR is "outdated and unnecessary" and that its abolition will help achieve a fairer tax system. That said, many who would disagree still see a role for FSR on termination payments where individuals have been working for substantial periods overseas. Instead, were assignees paid a bonus for overseas work undertaken whilst they were non-U.K. resident, this would not be taxable in the U.K. as earnings since it would be non-U.K. sourced.

Employers, particularly Human Resource directors, will need to consider the impact of the new approach on FSR (coupled with the other changes on termination payments noted above).

Points to consider include:

- whether the settlement should be grossed up to deliver the same net amount in cases where FSR is no longer available;
- factoring in the cost of any employer's NIC (post April 2019) on settlements that previously would have benefitted from FSR;
- changing internal procedures to establish settlements that can no longer avail of FSR, are identified and reported correctly;
- the treatment of termination payments within tax equalisation policies; and
- the timing of termination payments and compromise agreements and their interaction with an employee's tax residence position.

This last point may not be as simple as it sounds since consideration will be required on how the rules will apply where global mobility considerations are in play.

For employers with globally mobile employees, the removal of FSR may not necessarily mean that the whole payment is subject to tax in the United Kingdom.

In particular, where an employee has recently been on assignment overseas, the host location may wish to tax some or all of the payment and the U.K. may be required to give relief under a double taxation agreement. There may also be dual withholding obligations. It will therefore be important to review cross-border termination cases to foster the establishment of appropriate policies to deal with the consequences.

The new rules point towards different tax treatments for inbound and outbound assignees, i.e. depending on where they are tax resident in the tax year of termination.

Importantly, it is not the employee's status on the date of termination that is determinative but rather the residence position for the whole U.K. tax year of termination. In particular, an inbound assignee to the U.K. who is terminated after leaving the U.K. will still be impacted by the withdrawal of FSR where he or she still technically remains U.K. resident for the U.K. tax year of termination, notwithstanding split-year treatment.

Non-Compliance – Extension of Time-Limits in Offshore Cases

The government is extending the time limits for assessing all "offshore" cases to at least 12 years where non-compliant behaviour is involved, with a consultation on this in spring 2018. The current time limits are usually 4, 6, or 20 years depending on the behaviour that led to the non-compliance. It can take longer to establish the facts where offshore non-compliance is involved but, at the moment, time limits for onshore and offshore cases are the same. For offshore non-compliance, the time limit will be extended to at least 12 years, whatever the behaviour, to give more time to investigate offshore non-compliance. Where there is deliberate behaviour, the time limit for both onshore and offshore cases remains 20 years.

KPMG NOTE

This measure is part of the government's continued action to deal with non-compliance involving offshore issues. We have previously commented on the 'Requirement to Correct' – this provides individuals until 30 September 2018, to correct any non-compliance with respect to offshore issues which could affect current assignees and business travelers to the United Kingdom. (See our prior coverage of this in GMS *Flash Alert* 2017-154 (24 October 2017).)

Taxation of Employees' Business Expenses

Following the call for evidence published earlier this year, the government has announced its plans to make several changes to the taxation of employee expenses. There was apparently little evidence to support fundamental reform to the tax relief for employee expenses, and consequently the government has no further plans to do so. Instead, however, the following areas will see changes in the not too distant future:

Subsistence – benchmark scale rates: To reduce the burden on business, from April 2019 employers will no longer be required by HMRC to check receipts when reimbursing employees for subsistence using benchmark scale rates. Employers will only be asked to ensure that employees are undertaking qualifying travel. Note, however, that this welcome simplification does not apply to actual amounts reimbursed, or reimbursements made under agreed bespoke scale rates and industry-wide rates.

Subsistence – overseas scale rates: From April 2019, the existing concessionary accommodation and subsistence overseas scale rates will be placed on a statutory basis, to provide greater certainty for businesses. Employers will only be asked to ensure that employees are undertaking qualifying travel.

Guidance and claims process for employee expenses: HMRC will work with external stakeholders to improve the guidance on employee expenses, particularly on travel and subsistence and the process for claiming tax relief on non-reimbursed employment expenses. This programme of work will also take action to improve employee and employer awareness of the process and the rules.

KPMG NOTE

The changes are welcome as the current system can be fairly burdensome for both the employer and the employees, particularly with regard to the need to keep receipts. The full response to the call for evidence is expected to be published on 1 December.

Abolition of Class 2 NICs Deferred to April 2019

It had previously been announced that Class 2 NICs would be abolished from 6 April 2018. These are contributions made by the self-employed (but also by many outbound assignees from the U.K.) who choose to voluntarily pay Class 2 NIC while away from the U.K. in order to maintain their eligibility for U.K. state benefits, principally a U.K. state pension. The abolition has now been delayed by one year to allow for further consultation.

KPMG NOTE

A full year of Class 2 contributions would currently cost £148.20 in tax year 2017/18. When Class 2 contributions are abolished, individuals working and living outside the U.K. who wish to maintain their U.K. social security contribution record will instead have to opt to pay Class 3 NIC. A full year of Class 3 contributions costs significantly more at £741.00 a year based on current rates. An additional year at the lower rate will therefore be welcomed.

Off-Payroll Workers in the Private Sector

As widely trailed in recent weeks, the government has announced its intention to consult on the extension to the private sector of the IR35 reforms which were introduced in the public sector earlier this year. The consultation will take account of experiences in the public sector since April 2017 and will include the findings from external research already commissioned by the government and due to be published in 2018**.**

KPMG NOTE

The likely extension of these rules will be a concern to many businesses that engage workers who provide their services via Personal Service Companies. However, the consultation is nevertheless welcome in the sense that it does at least suggest the government's willingness to listen ahead of introducing further reforms, and provides further time for businesses to prepare as required.

Employment Status and the Taylor Review

The government has announced that it will publish a discussion paper as part of its response to Matthew Taylor's review of employment practices in the modern economy, exploring the case and options for longer-term reform to make the "employment status" tests for both employment rights and tax clearer.

KPMG NOTE

We are expecting to see the government's response to the Taylor Review before Christmas, and this may complement the report and recommendations published jointly by the Work & Pensions and Business, Energy & Industrial Strategy Committees on Monday, 20 November, a summary of which can be found here.

Clearly the IR35 rules and the employment status of workers remain key areas of focus for HMRC and the Treasury. However, as KPMG LLP (U.K.) has previously noted, we would welcome a more fundamental review of the way in which the U.K. taxes labour in the 21st century. We would hope that any future reform will lead to a narrowing of the current fiscal differences between employment and self-employment, reducing their influence on the way in which workers are engaged, particularly as regards the NIC position.

Tax-Free Dividend Allowance

It was previously confirmed that the tax-free dividend allowance of £5,000. which was introduced on 6 April 2016, is to be reduced to £2,000 from 6 April 2018. This was no further announcement on this in the Budget.

KPMG NOTE

This is a measure targeting individuals who use their own company to provide services to a business and therefore pay a lower tax than employed or self-employed individuals. Employees who own shares in their employer's business, or otherwise as part of a personal portfolio, may also pay more tax on their dividend income as a result.

Personal Income Tax Rates

Income tax rates and thresholds for 2018/2019 are as shown in the table on the following page.

	Rate	2017/18	2018/19
Personal Allowance	0%	£11,500	£11,850
Basic rate	20%	£0 - £33,500	£0 - £34,500
Higher rate	40%	£33,501 - £150,000	£34,501 - £150,000
Additional rate	45%	Over £150,000	Over £150,000

Next Steps

We are expecting a number of more detailed documents and consultation papers to be released over the coming weeks.

KPMG LLP (U.K.) will endeavour to keep readers informed of any further developments that concern individuals, including those on international assignment, and their multinational employers.

FOOTNOTE:

1 For the U.K.'s "Autumn Budget 2017," click here.

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Contact us

For additional information or assistance, please contact your local GMS or People Services professional or one of the following professionals with the KPMG International member firm in the United Kingdom:

Colin Ben-Nathan
Tel. + 44 (0) 20 7311 3363
Colin.Ben-nathan@kpmg.co.uk

Rachel Beecroft
Tel. + 44 (0) 20 7311 3356
Rachel.Beecroft@kpmg.co.uk

Matthew Fox
Tel. +44 (0) 20 7694 3392
Matthew.Fox@kpmg.co.uk

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