TC02113

Appeal number: TC/2011/08630

INCOME TAX – payment in consequence of the termination of contract of employment – whether within Ch.3, Pt. 6, ITEPA and subject to exemption from tax for the first £30,000 under s.403 ITEPA, or 'earnings' within s. 62, ITEPA – contractual provision in the contract of employment for payment in lieu of notice – whether payment made pursuant to that provision or alternatively as compensation for loss of the employment – held the source of the payment was the contractual provision in the contract of employment for payment for service under notice or in lieu of notice and the payment was therefore 'earnings' within s.62 ITEPA – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

GRANT HAYWARD **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE JOHN WALTERS QC
HELEN MYERSCOUGH

Sitting in public at Colchester on 11 June 2012

The Appellant did not appear and was not represented

Mrs C Douglas, HMRC, for the Respondents

DECISION

1. The appellant, Mr Grant Hayward ("Mr Hayward") appeals against an amendment of his self-assessment tax return for the year ended 5 April 2004. The amendment was to include as income chargeable to income tax the whole of the payment of £37,500 made to Mr Hayward on the termination of his employment with Garban-Intercapital Management Services Limited ("ICAP"). We refer to this payment as "the Payment". Mr Goldman's return had been completed without the inclusion of the Payment, or of the income tax of £8,250 deducted at source by ICAP on making the Payment.

2. The issue raised by the appeal is whether or not the Payment falls to be taxed as earnings from Mr Hayward's employment with ICAP. Mr Hayward's case is that the Payment was compensation for loss of employment on his being made redundant by ICAP. If this is the correct analysis, £7,500 of the Payment was chargeable to income tax, but the remaining £30,000 was not chargeable to income tax as being the first £30,000 of a payment on termination of employment within Chapter 3, Part 6, Income Tax (Earnings and Pensions) Act 2003 ("ITEPA") – see, specifically, section 403(1) ITEPA which provides as follows:

> '(1) The amount of a payment or benefit to which this Chapter applies counts as employment income of the employee or former employee for the relevant tax year if and to the extent that it exceeds the £30,000 threshold.'

3. The Respondent Commissioners ("HMRC") contend that the Payment was not a payment to which Chapter 3, Part 6, ITEPA applies and that, instead, the whole amount of the Payment (£37,500) counts as earnings from Mr Goldman's employment with ICAP and is 'earnings' within the general definition in 62 ITEPA, with the consequence that it is 'general earnings' within section 7(3) ITEPA, 'taxable earnings' within section 15(2) ITEPA, 'net taxable earnings' within section 11 ITEPA and therefore within the charge to tax on employment income provided by section 9(2) ITEPA.

4. Mr Hayward was neither present nor represented at the hearing. However he had been notified of it and the Tribunal Centre received an email from him dated 11 June 2012 (timed at 08:07), and this email was before the Tribunal at the hearing. In the email he stated that he would be unable to attend the hearing and added 'a couple of points I would like to reiterate'.

5. In these circumstances we decided to proceed with the hearing of the appeal pursuant to rule 33 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, considering that it was in the interests of justice to do so.

6. We were provided with a bundle of documents, from which we find the following facts.

The facts

7. Mr Hayward's service agreement ("the Service Agreement") with ICAP (then called Intercapital Brokers Limited) was dated 14 July 1997. His employment was 'as Broker' subject to the terms of the Service Agreement (clause 1.1). His appointment commenced on 1 September 1997 and was for an initial 3-year period.

8. Thereafter it was subject to automatic renewal on a yearly basis (renewal for a 'Renewal Period') 'unless and until terminated by either party giving to the other not less than six months' notice in writing expiring at the end of either the initial fixed period … or a Renewal Period' (clause 1.2.2).

9. Mr Hayward's basic remuneration under the Service Agreement was stated to be £100,000 per annum (subject to deductions) (clause 3.1.1). He was also entitled to be paid a bonus in certain circumstances (clause 3.3.1). Clause 10 of the Service Agreement dealt with termination of the employment.

10. First of all it made provision (by clause 10.1) for termination of the employment by the employer without notice or payment in lieu of notice in certain circumstances which are irrelevant to the appeal.

11. By clause 10.2 provision was made for termination 'on not less than three months' notice in writing expiring at any time' if certain revenue-generation targets had not been met. There was no suggestion that this provision was relevant to the appeal.

12. If either party (Mr Hayward or the employer) gave notice to terminate the employment, Mr Hayward agreed that the employer in its absolute discretion could require him to take 'Garden Leave' for a period or periods not exceeding six months in aggregate (clause 10.3.1). He would be entitled to his salary and contractual benefits during a period of 'Garden Leave'. A requirement to take 'Garden Leave' was expressly recognised not to constitute a breach of the Service Agreement (clause 10.3.2).

13. Clause 10.5 was in the following terms:

> 'The Company may in its absolute discretion elect to terminate the contract immediately and make a payment in lieu of any applicable period of notice or the remainder of any fixed term of this Agreement. The Employee is required to mitigate his loss where this Agreement is terminated in accordance with this Claude 10.5 and any payment in lieu of notice may be reduced to take account of mitigation.'

14. Clause 11 provided that a termination of the employment pursuant to (though not in breach of) the Service Agreement would oblige Mr Hayward, if required by the employer, to resign without claim for compensation.

15. In June 2003 (that is, well after the end of the initial fixed period of the employment), there were discussions between Mr Hayward and ICAP as a result of which his employment terminated. Mr Hayward took the advice of Berwin Leighton Paisner, Solicitors, and a compromise agreement ("the Compromise Agreement")

contained in a letter dated 29 June 2003 was entered into by Mr Hayward and ICAP. Its terms were as follows:

> 'Further to our recent discussions, I confirm the agreed provisions concerning termination of your employment by reason of redundancy. In consideration of the mutual agreements herein contained, we agree as follows:
>
> 1. Your employment shall terminate as of 30th June 2003 by mutual agreement up to which date you will be paid your Salary and benefits in the usual way together with a payment in lieu of 4 days unutilised holiday. You will not be entitled to any bonuses whatsoever.
>
> 2. Payment. Without any admission of liability, after issuing your P45, the Company shall within 7 days of receipt of this properly signed agreement, pay to you £37,500 (subject to the usual deductions for tax and National Insurance) as compensation for loss of employment less debts you owe to the Company or its Group Companies amounting to £18,147.02 and less any overpayments of salary paid to you in error (if any).'
>
> 3. [Provision for reimbursement of business expenses and settlement of a company credit card.]
>
> 4. [Provision for ICAP to contribute to Mr Hayward's legal expenses, including independent legal advice in connection with the Compromise Agreement.]
>
> 5. and 6. [Mutual release of obligations under the Service Agreement.]
>
> 7. [The payments and terms of the Compromise Agreement to be accepted by Mr Hayward in full and final settlement of any employment law claims against ICAP.]
>
> 8. [Recognition that the Compromise Agreement is a compromise agreement within section 203 of the Employment Rights Act 1996, and Mr Hayward's warranty that he will make no complaint to the Employment Tribunal or other court and that he has received independent legal advice.]

16. ICAP paid Mr Hayward on 2 July 2003 a gross amount of £37,500, from which income tax of £8,250 was deducted. This was a deduction at a rate of 22 per cent. The exemption for £30,000 of a payment for compensation for loss of office under section 403(1) ITEPA was not applied. There is no evidence that Mr Hayward complained about this deduction (which it would not have been appropriate for ICAP to make if section 403(1) ITEPA applied to the Payment). However, he appears to have obtained a repayment of tax from HMRC following the end of the year 2003/2004 of £4,666.66. The amendment to his self-assessment seeks to recoup that amount and charge an additional £3,733.34, making a total adjustment of £8,400, being HMRC's estimation of the tax lost.

17. Mr Hayward reported in his tax return for the year ended 5 April 2004 income from his employment with ICAP as £20,052 and tax deducted therefrom of £7,855.90. There is a suggestion that this accorded with the P45 form which was originally issued to him, but we had with our papers an amended P45 form showing income of £20,052 and tax deducted of £6,205.90. Mrs Douglas informed us that HMRC's records showed that £6,205.90 of income tax had been deducted and accounted for by ICAP in respect of Mr Hayward's employment in that year and we find as a fact that this was so. It appears that this figure does not include the tax of £8,250 deducted from the Payment.

18. It also appears from Mr Hayward's tax return that he managed to secure alternative employment in the year ended 5 April 2004 – with Martin Brokers Group Limited – and that he returned earnings in that year from that employment of £15,000, with tax deducted of £3,475.56.

19. HMRC opened an enquiry into Mr Hayward's return for the year ended 5 April 2004 on 14 October 2005. In the course of that enquiry HMRC corresponded with ICAP. On 13 February 2007 a Ms Sarah Zaldi of ICAP sent a fax to HMRC stating that the payment of £37,500 made to Mr Hayward had been 'a contractual Payment in Lieu of Notice'. HMRC informed Ms Zaldi that the Compromise Agreement described the payment as being made by reason of redundancy but Ms Zaldi confirmed, in a letter dated 1 March 2007 to HMRC that it was 'a contractual payment in lieu of notice'.

20. HMRC wrote to ICAP on 18 September 2007 enquiring whether the Payment besides being a payment in lieu of notice also contained an element of compensation for redundancy. The response from ICAP, dated 30 October 2007, was that the Payment was entirely in lieu of notice and represented six month's pay, Mr Hayward's salary being £75,000 per annum. The letter concluded: 'As he has a contractual PILON clause, the settlement was subject to deductions [*sic*] of tax'.

The parties' submissions

21. Mr Hayward's email to the Tribunal Centre of 11 June 2012 made clear that his case (as also indicated in the correspondence) was that the Payment was not a contractual payment in lieu of notice but a payment on redundancy as compensation for loss of employment.

22. Mrs Douglas, for HMRC, accepted that the best evidence for the reasons for making the Payment was to be found in the Compromise Agreement which provided for its payment. But she submitted that the terms of the Compromise Agreement had to be considered against the factual background of the relevant provisions of the Service Agreement and also ICAP's understanding as stated in the subsequent correspondence between ICAP and HMRC. She cited *EMI Group Electronics Ltd. v Coldicott* 71 TC 455 (a decision of the Court of Appeal in 1999), *Richardson v Delaney* 74 TC 167 (a decision of Lloyd J in 2001), *Dale v de Soissons* 32 TC 118 and *Norman v Golder* 26 TC 295. She submitted that on a proper analysis the Payment was a payment in lieu of notice and all of it was chargeable to income tax under section 62 ITEPA, as earnings from Mr Hayward's employment with ICAP.

Discussion and Decision

23. The Court of Appeal in *EMI Group Electronics* held that a payment in lieu of notice made in pursuance of a contractual provision, agreed at the outset of the employment, which enables the employer to terminate the employment on making that payment, is properly to be regarded as an emolument from that employment, falling squarely within the tests posed by Lord Radcliffe in *Hochstrasser v Mayes* 38 TC 673 as being 'paid to him in return for acting as or being an employee' and by Lord Templeman in *Shilton v Wilmhurst* 64 TC 78 as being 'an emolument from being or becoming an employee'.

24. Chadwick LJ said of a payment in lieu of notice made under an express provision of a contract of employment that the employment may be terminated either by notice or on payment of a sum in lieu of notice, that the payment was not a payment for work done under the contract of employment but neither was it a payment made by way of compensation or damages for breach of the contract of employment (*ibid.* p.489).

25. Chadwick LJ also considered (see *ibid.* at p.490) that the reason why an employee is entitled to a payment in lieu of notice must be that this is the security, or continuity, of salary which he required as an inducement to enter into the employment.

26. There is therefore no doubt that if ICAP had paid to Mr Hayward a payment in lieu of notice plainly in all respects in accordance with clause 10.5 of the Service Agreement, such payment would have ranked as an emolument of his employment, or, in terms of ITEPA, 'earnings' within the general definition in section 62 ITEPA.

27. However, ICAP paid the Payment pursuant to the Compromise Agreement, which described the Payment as compensation for loss of employment, and, pursuant to clause 7 of the Compromise Agreement, the Payment was clearly to some extent consideration for the surrender of Mr Hayward's employment law rights to make claims against ICAP as therein referred to.

28. The Compromise Agreement must be seen against the background of Mr Hayward's accrued rights under the Service Agreement. These rights were (1) to not less than six month's paid notice in writing expiring at the end of a Renewal Period – which could, clearly, be a right to more than six month's paid notice – clauses 1.2.2 and 10.3.1; (2) alternatively to a contractual payment in lieu of notice, should ICAP elect to terminate Mr Hayward's contract of employment immediately – clause 10.5.

29. We note that the contractual payment in lieu of notice under clause 10.5 of the Service Agreement stood to be reduced in the event where Mr Hayward's loss on the termination of his employment with ICAP was mitigated. This provision could have affected his contractual rights as against ICAP in view of the fact that he evidently secured another employment (with Martin Brokers Group Limited) before 5 April 2004. However there was no evidence before us to enable us to conclude that he did in fact mitigate his loss in this way. We conclude therefore that his contractual right to a payment in lieu of notice under clause 10.5 of the Service Agreement was a contractual right to be paid at least six months' salary, which we take to have been £37,500 on the basis that, as ICAP stated to HMRC in their letter dated 30 October 2007, his salary was £75,000 per annum in 2003.

30. The Compromise Agreement makes no reference to these accrued rights. It proceeds on the basis that Mr Hayward's employment was terminated by reason of redundancy – a fact that was impliedly denied by ICAP in their letter to HMRC dated 30 October 2007.

31. By implication, if not by the express terms of clause 7 of the Compromise Agreement, Mr Hayward surrendered his accrued rights under the Service Agreement in consideration of the Payment.

32. He also, as stated above, surrendered his employment law rights in consideration of the Payment, but as there was no evidence before us as to the value of those rights, we cannot find as a fact that any identifiable part of the Payment was attributable to the value of those rights.

33. The question of whether the Payment is properly to be regarded as earnings from Mr Hayward's employment within section 62 ITEPA depends on whether or not it was paid to Mr Hayward 'in return for acting as or being an employee' – *Hochstrasser v Mayes* 38 TC 707, cited by Chadwick LJ in *EMI Group Electronics*.

34. There is no evidence (other than the wording of the Compromise Agreement itself) that the Payment was compensation for Mr Hayward's loss of his employment. On the other hand, it is clear that it was (in part, at any rate) consideration for Mr Hayward's surrender of his accrued right to be paid at least six months' salary either for working out his notice, whether or not by way of 'Garden Leave' (clause 1.2.2 of the Service Agreement), or by way of a contractual payment in lieu of notice under clause 10.5 of the Service Agreement.

35. It also follows from the fact that we have no evidence to enable us to attribute any identifiable part of the Payment to the value of his surrendered employment law rights that we must find as a fact that the whole of the Payment was consideration for Mr Hayward's surrender of his accrued right to be paid at least six month's salary as above.

36. As Mr Hayward's right to be paid at least six months' salary for working out his notice or by way of a contractual payment in lieu of notice was (on the authority of *EMI Group Electronics*) a right accruing to him 'in return for acting as or being an employee', it follows in our judgment that the Payment also had that character, being consideration received by Mr Hayward for the surrender of such right. The source of the Payment was accordingly in the Service Agreement.

37. The fact that the Payment is described as compensation for loss of employment on redundancy in the Compromise Agreement cannot affect this conclusion. Further, on a view of all the relevant facts as set out above, we consider that the wording of the Compromise Agreement in this regard was probably settled with a view to assisting Mr Hayward to put forward a claim to the exemption of £30,000 under section 403(1) ITEPA. Certainly, the fact that ICAP appear to have acted at all times subsequent to entering into the Compromise Agreement – that is, on making the Payment wholly under deduction of tax and in later correspondence with HMRC – on the basis that in their view the Payment was a contractual payment in lieu of notice reinforces our conclusion.

38. The Payment therefore was for these reasons earnings of Mr Hayward's employment, taxable in full under section 62 ITEPA. The appeal accordingly is dismissed.

39. If Mr Hayward's argument were correct, it would be open to anyone entitled to a contractual payment in lieu of notice (which on authority is taxable as 'earnings' within section 62 ITEPA) to enter into an agreement describing the payment as compensation for loss of employment, and thus achieve exemption from tax under section 403 ITEPA in respect of the first £30,000. This would not be a sensible result consistent with a purposive interpretation of the legislation.

40. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JOHN WALTERS QC
TRIBUNAL JUDGE

RELEASE DATE: 4 July 2012