



Neutral Citation: [2022] UKFTT 00421 (TC)

Case Number: TC08640

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

By remote video hearing

Appeal reference: TC/2021/01402

*INCOME TAX - section 225 ITEPA 2003 - whether payment for a restrictive undertaking in connection with the individual's current, future or past employment - yes - section 401 ITEPA 2003 - whether payment to appellant by employer under settlement agreement indirectly in consequence of, or otherwise in connection with, the termination of employment - yes - appeal dismissed*

**Heard on:** 11 October 2022

**Judgment date:** 14 November 2022

**Before**

**TRIBUNAL JUDGE GREG SINFIELD  
TRIBUNAL MEMBER NOEL BARRETT**

**Between**

**MRS A**

**Appellant**

**and**

**THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS  
Respondents**

**Representation:**

For the Appellant: Mark Fink, chartered tax adviser

For the Respondents: Joshua Carey, counsel, with Marianne Tutin, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

## DECISION

### INTRODUCTION

1. This is an appeal by Mrs A against a closure notice for the 2018-19 tax year issued by the Respondents ('HMRC') on 5 January 2021. The closure notice reduced a claim made by Mrs A in her self assessment tax return for 2018-19 for a repayment of overpaid tax of £467,683.82 to a refund of £6,136.02. The amount at stake in this appeal is, therefore, £461,547.80.
2. The claim for repayment related to income tax deducted on a payment of £1,055,000 ('the Compensation Sum') paid to Mrs A under an agreement ('the Settlement Agreement') dated 11 May 2018 between Mrs A and her employer ('the Employer'), and its owner ('the Owner').
3. In the Settlement Agreement, Mrs A agreed to withdraw her claim against the Employer and the Owner in the Employment Tribunal and waive any other claims she may have had against them. She also agreed to be bound by certain confidentiality and non-disclosure obligations in relation to, among other things, the Employment Tribunal claim and the events that gave rise to it, and the Settlement Agreement. Mrs A's claim in the Employment Tribunal related to a grievance that she had brought under the Employer's grievance procedure alleging, among other things, sexual harassment by the Owner. The Owner has always denied the allegations made by Mrs A. Whether the allegations have any foundation is irrelevant to the issue to be decided in this appeal and we make no findings in relation to them save as to record the process that led to the making of the Settlement Agreement on 11 May 2018 and the payment of the Compensation Sum.
4. HMRC took the view that the Compensation Sum was taxable under section 401(1) and section 403(1) of the Income Tax (Earnings and Pensions) Act 2003 ('ITEPA'). Those provisions treat payments which are received directly or indirectly in consideration or in consequence of, or otherwise in connection with, the termination of a person's employment as employment income of the employee for the tax year in which it is received if and to the extent such payments exceed £30,000.
5. Mrs A contended that the Compensation Sum had no connection with the termination of her employment by the Employer but was wholly in consideration of her agreeing to enter into the confidentiality and non-disclosure obligations. As such, Mrs A contended that the Compensation Sum did not fall within section 401(1) or the charge to tax under any other provision.
6. HMRC, however, argued that if the Compensation Sum was consideration for Mrs A entering into the confidentiality and non-disclosure obligations in the Settlement Agreement then it was payment for a restrictive undertaking in connection with her current, future or past employment and taxable under section 225 ITEPA as earnings from employment for the tax year in which it was made. Mrs A accepted that the confidentiality and non-disclosure obligations are "an undertaking which restricts [her] conduct or activities", which is the definition of "restrictive undertaking" in section 225(8). She submitted, however, that the definition should be qualified by adding the words "in connection with her current, future or past employment" from section 225(1) after "restrictive undertaking". If read in that way, Mrs A argued, then the confidentiality and non-disclosure obligations did not fall within section 225 because they did not restrict her conduct or activities in relation to any employment.
7. Accordingly, the only issues in this appeal are:
  - (1) whether the Compensation Sum was received directly or indirectly in consideration or in consequence of, or otherwise in connection with, the termination of Mrs A's

employment or for something else, eg withdrawing the Employment Tribunal claim and/or entering into the confidentiality and non-disclosure obligations; and

(2) if the Compensation Sum was consideration for Mrs A entering into the confidentiality and non-disclosure obligations, whether it was payment for a restrictive undertaking in connection with Mrs A's current, future or past employment.

8. Having heard the evidence for Mrs A and the submissions of both parties, we have decided that, for the reasons set out below, Mrs A's appeal must be dismissed.

9. With the consent of the parties, the hearing was held by video using the Tribunal video hearing system. The hearing had originally been listed to take place by video because of the Covid 19 pandemic. Subsequently, the parties asked for the hearing to be face to face but no hearing room was available in the most convenient venue for Mrs A on the hearing dates and, rather than lose the dates, the parties elected to proceed with the hearing by video.

10. The video hearing was attended by Mrs A, her representative Mr Mark Fink and her witness Ms B. For HMRC, the hearing was attended by Mr Joshua Carey and Ms Marianne Tutin, both of counsel, and by a member of HMRC's Solicitor's Office and various HMRC observers. The documents to which we were referred were a main bundle of 313 pages, an authorities bundle of 475 pages, Mrs A's skeleton argument of 21 pages and HMRC's skeleton argument of 13 pages.

11. Following an application made by Mrs A under rule 32 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ('the FTT Rules'), Judge Vos made a direction, in April 2022, that the hearing should be held in private and any decision published subsequently should be anonymised. Accordingly, no prior notice of the hearing or information about how members of the public could observe the hearing remotely was published on the gov.uk website.

#### **EVIDENCE**

12. As stated above, we were provided with a hearing bundle which contained the documents on which the parties relied and to many of which they referred. The bundle also contained three witness statements: one from Mrs A and two others from witnesses giving evidence on her behalf: Ms B and Mr C.

13. Mr C was unable to attend the hearing and so was not available to answer any questions that Mr Carey might have wished to put to him. Accordingly, although we had read Mr C's witness statement, we have given it no weight in reaching our decision.

14. Ms B did attend the hearing but Mr Carey stated that he did not have any questions for her. In the absence of any cross-examination by HMRC, we accept Ms B's evidence in her witness statement. In summary, her evidence was that she was Senior Retail Operations Manager for the Employer from September 2009 until the business went into administration in 2021. In October 2017, Mrs A asked Ms B to act as her representative during a grievance process against the Owner and Ms B agreed. Ms B describes the grievance process and certain meetings that she attended with Mrs A or observed between Mrs A and the Owner between the final grievance appeal outcome meeting and Mrs A leaving the business in May 2018. Although we accept it as truthful, we find that Ms B's evidence has no relevance to the issues that we must decide in this appeal.

15. At the hearing, Mrs A gave evidence and was asked questions by Mr Carey. We found Mrs A to be credible and fully accept her evidence of matters of fact about the grievance procedure, the Employment Tribunal proceedings and her interactions with the Owner in the weeks immediately preceding the signing of the Settlement Agreement which we incorporate in our findings of fact below. We do not accept her evidence of the intent or effect of the

Settlement Agreement for the purposes of ITEPA which is a question of law to be resolved by construction of the terms of the Settlement Agreement in their factual context.

#### **FINDINGS OF FACT**

16. On the basis of the statement of agreed facts and evidence, both written and oral, we find the material facts to be as follows.

17. Mrs A had worked for the Employer since May 2007. From June 2012, Mrs A was employed as Head of Retail in the Employer and, in 2017, was acting as Interim Retail Director.

18. In a formal grievance letter dated 23 October 2017, Mrs A raised a grievance against the Employer and the Owner alleging, among other things, harassment on the grounds of sex, bullying, victimisation and intimidation by the Owner. When she raised the grievance with the Employer, Mrs A's intention was that the Employer would help her to resolve the situation and carry on with her job. She was not seeking anything other than for the harassment to stop. When Mr Carey put it to her that it would be difficult to return to work in the circumstances, Mrs A agreed but maintained that she did want to go back and had told the HR Director this.

19. The Employer's grievance procedure was brought to an end by a letter dated 18 December 2017 which did not uphold Mrs A's grievance. As was permitted by the relevant policy, Mrs A lodged an appeal against the outcome of the grievance procedure by a letter dated 28 December 2017. The Employer responded in a letter dated 24 January 2018 which ends

“I realise that you did not enter into this process lightly, and very much hope that you can focus on your continued bright future with the Employer. I apologise on behalf of the Employer for any upset and hurt that this may have caused you.

You have now exhausted your right of appeal under our Problem Solving procedure and this concludes our internal procedure. May I remind you that this grievance and process is to be kept confidential.”

20. Mrs A was very dissatisfied with the Employer's internal grievance process and its conclusion. On 6 February 2018, Mrs A began proceedings in the Employment Tribunal against the Employer and the Owner.

21. The hearing bundle included a letter dated 7 March 2018 from PD Tax Consultants to Mrs A providing “advice in relation to the proposed settlement structure”. It was a detailed letter of some ten pages. Its author covered the tax treatment of payments under settlement agreements but all the examples were predicated on there also being a termination of employment and discussed the tax treatment of a payment under section 401 ITEPA. The letter included the following advice about the drafting of such an agreement to strengthen the case that it did not fall within section 401 ITEPA:

“... the compromise agreement should be drafted such that the compensation payment is being made in settlement of the claims [for alleged sex discrimination], and not in relation to the termination of employment itself.”

22. The letter from PD Tax Consultants also included advice about the tax consequences of entering into a restrictive covenant:

“Care should be taken if part of the agreement relates to confidentiality. If there is an undertaking of confidentiality signed as part of the agreement, then any payment associated with this will be treated as taxable as normal employment earnings under ITEPA s225.”

23. When this letter was put to her by Mr Carey, Mrs A acknowledged that it referred to termination but did not accept that it referred to the Settlement Agreement. She said that a settlement agreement had not been proposed at that stage but that her lawyer had outlined and explored all potential options and outcomes including their tax consequences. Mrs A said that she did not consider leaving the Employer until her last conversation with the Owner some time in late April.

24. Mrs A told us that she was subject to a great deal of pressure, including from the Owner personally, to drop her case in the Employment Tribunal. Mrs A said that, on several occasions in the weeks leading up to her leaving, the Owner had offered to write her increasingly large personal cheques if she would withdraw the proceedings in the Employment Tribunal and maintain confidentiality but she had refused to deal with him on this basis.

25. On 11 April 2018, Mrs A filed amended grounds of complaint with the Employment Tribunal.

26. Mrs A's last conversation with the Owner was at the end of April 2018. She also had a meeting with Ms C, Chief People Officer of the Employer. At that meeting, Mrs A told Ms C that she could not go on and had decided to leave the Employer. Mrs A said that until then she had fully intended to stay in the Employer but, in the face of the pressure to drop the proceedings, eventually realised that she had no choice but to leave her job for her health and sanity.

27. Immediately after that meeting, Mrs A called her lawyer and told her that she could not cope any more and would leave the Employer. Negotiations in relation to the Settlement Agreement began from that point, ie the end of April 2018.

28. There was no horse trading or lengthy negotiation about the amount payable under the Settlement Agreement. Mrs A said that it all happened very quickly. The Owner had raised the possibility of a payment of over £1 million. She said that it was agreed that the payment would be £1.1 million, ie £1,055,000 plus £45,000. Mrs A said that her solicitor just contacted her when necessary and she was not aware of any other figures being discussed.

29. On 11 May 2018, following negotiations, Mrs A, the Employer and the Owner entered into the Settlement Agreement. The construction of the Settlement Agreement is central to resolving the issues in this appeal so we set out its material provisions in some detail:

**“BACKGROUND**

We have employed you as a head of retail of [the Employer], though you have most recently been acting as interim retail director, under a contract of employment dated 27 June 2012. You raised a grievance against [the Owner] on 23 October 2017 alleging, amongst other things, harassment on the grounds of your sex ('the Grievance'). The Grievance has concluded and you have issued proceedings in the Employment Tribunal ... ('the Tribunal Claim').

It has now been agreed that you will settle the Tribunal Claim together with all and any claims you may have against us and [the Owner], and also that your employment will terminate on 10 May 2018.

This agreement sets out the arrangements we have agreed relating to your employment, the termination of your employment and the basis on which you have agreed to settle the Tribunal Claim and any claims you may have against [the Owner], the Employer, associated employer or any associated persons relating to your employment or its termination.

IT IS AGREED as follows:

**1. DEFINITIONS**

...

‘Confidential Information’ means any information of a confidential or secret nature relating to any aspect of the business or affairs of [the Owner], the Employer and/or any Associated Employer and/or any Associated Persons, clients~ customers and suppliers including but not limited to personal data, financial information, budgets, reports, business plans, strategies, know-how, formulae, designs, data, specifications, research, processes, procedures and programs, pricing, sales and marketing plans and details of past or proposed transactions whether or not written or computer generated or expressed in material form.

...

‘Payment Date’ means the date which is 3 working days after the Termination Date or receipt by the Employer of a copy of this Agreement signed by you and a letter from the Adviser as set out in the form of Appendix 1 together with the letter withdrawing the Tribunal Claim as set out in Appendix 2 being sent to the Employment Tribunal, whichever is later.

...

‘Tax’ means income tax and employee's national insurance.

‘Termination Date’ means 10 May 2018.

‘Tribunal Claim’ means the claim brought by you against the Employer and [the Owner] in the Employment Tribunal ...

## 2. TERMINATION

2.1 Your Employment will terminate on the Termination Date.

...

## 4. SETTLEMENT

4.1 Without any admission of liability, we agree to pay to you (for ourselves and also on behalf of [the Owner]) the following:

4.1.1 the sum of £45,000 (‘the Tribunal Claim Compensation Sum’) as compensation for injury to feelings and aggravated damages in full and final settlement of the Tribunal Claim;

4.1.2 the sum of £1,055,000 (‘the Compensation Sum’) as compensation for the termination of your employment and any and all claims you have or may have against the Employer, [the Owner] or any Associated Persons or any Associated Employer, subject to the warranties given by you and subject to your acceptance of and compliance with the other terms of this Agreement; and

4.1.3 between the date of this Agreement and 30 November 2018, you will also be paid a further monthly compensation sum on or around the 24th of each month which is £14,083 and this will be subject to deductions for Tax (‘the Monthly Compensation Sum’). The Monthly Compensation Sum is further compensation for the termination of your employment and any and all claims you have or may have against the Employer, [the Owner] or any Associated Persons or any Associated Employer, and it will be paid strictly subject to the warranties given by you and subject to your acceptance of and compliance with the other terms of this Agreement. If there is any breach by you of any of the terms of this Agreement, you acknowledge and agree that we and [the Owner] will be under no obligation to pay to you any or all of the Monthly Compensation Sum.

4.2 Both the Tribunal Claim Compensation Sum and the Compensation Sum will be paid to you on or before the Payment Date subject to your compliance with the terms of this Agreement and also withdrawing the Tribunal Claim in accordance with Appendix 2.

4.3 For tax purposes, you agree and warrant that, other than the payments in clauses 3 and 4, you have not received any prior payments in respect of this termination of employment.

4.4 It is the Parties (sic) reasonable belief that the Tribunal Claim Compensation Sum can be paid without deduction for Tax.

4.5 You and the Employer agree that the following tax arrangements apply in respect of the Compensation Sum:

4.5.1 The Employer's payroll team, using its reasonable endeavours, shall calculate the amount of the Compensation Sum which is Post-Employment Notice Pay, if any, and is taxable as earnings. The Employer shall promptly notify you of the amount and will deduct Tax from it at the appropriate rate.

4.5.2 The next £30,000 of the Compensation Sum (or such lesser sum as is payable) will be tax free, as a termination award under the threshold within the meaning of sections 402A(1) and 403 of ITEPA.

4.5.3 The balance of the Compensation Sum will be taxable as a termination award exceeding the threshold within the meaning of sections 402A(1) and 403 of ITEPA. The Employer shall accordingly deduct income tax from it at the appropriate rate.

4.5.4 You shall be responsible for any further Tax due in respect of the Compensation Sum and shall indemnify the Employer in respect of such liability in accordance with clause 16. If at any point any part of the Compensation Sum is found to be subject to Tax and Tax was not deducted pursuant to this clause, the Employer will either deduct such Tax required before payment or if the payment has already been made will rely on the indemnity referred to in clause 14.

4.5.5 You and the Employer agree that any sums (which otherwise would be tax free) may be subject to Tax as a result of a salary sacrifice or any other event as detailed in section 402D(7)(b) of the Income Tax (Earnings and Pensions) Act 2003 and in calculating the Tax to be deducted pursuant to clause 4.5, the Employer will from 6 April 2018 take account of this provision.

4.6 Save as set out in this Agreement, we will cease to provide you with all other benefits, whether contractual or otherwise, with effect from the Termination Date.

...

## 9. CONFIDENTIALITY OF AGREEMENT

9.1 You warrant that you have not disclosed to anyone (other than your immediate family in confidence and/or to your professional advisers in connection with the conclusion of this Agreement) the facts and circumstances surrounding your Grievance, the termination of your Employment; the submission of the Tribunal Claim and the contents therein; the facts of, negotiation and/or terms of this Agreement.

9.2 You warrant that except for in accordance with clause 13 you will not disclose in the future to anyone the circumstances relating to the Grievance,

the termination of your Employment; the submission of the Tribunal Claim and the contents therein; and/or the fact of, negotiation and/or terms of this Agreement (except to your immediate family in confidence and your professional advisers, or where required by any governmental, regulatory or other competent authority or by a Court of law or Her Majesty's Revenue and Customs).

9.3 The Employer confirms that it will not authorise its directors, officers and employees to disclose the circumstances relating to the Grievance and the Tribunal Claim, the termination of your Employment and the fact of, negotiation and/or terms of this Agreement (except where required by any governmental, regulatory or other competent authority or by a Court of law or Her Majesty's Revenue and Customs or as required for any of our internal reporting purposes or for the purposes of ensuring compliance with or enforcing the terms of this Agreement).

...

## 11. STATEMENTS

11.1 You will not, directly or indirectly, make any detrimental or derogatory statements about your Employment, its termination, [the Owner], the Employer or any Associated Persons or any Associated Employer except in accordance with clause 13.

11.2 Except in circumstances where it is alleged that you have breached the terms of this Agreement, [the Owner] will use all reasonable endeavours to not, directly or indirectly, make any detrimental or derogatory statements about you and the Employer and Associated Employer will not authorise any Associated Persons to make any detrimental or derogatory statements about you.

11.3 It is agreed that your departure from the Employer will be announced internally firstly at an internal conference call on 11 May 2018 where you will speak to your immediate reporting line, and then to the wider team (in both respects you will follow the script set out in Appendix 4). Subsequently an internal email will be sent in the format set out in Appendix 4. None of the Parties shall deviate from the statements set out in Appendix 4 when describing your departure to any third party unless required by law or a statutory or regulatory authority.

## 12. CONFIDENTIAL INFORMATION

12.1 You confirm that you will continue to abide by your on going (sic) obligations of confidence to the Employer or any Associated Employer set out in your Contract of Employment.

12.2 You undertake that except in accordance with clause 13 you will not disclose to any person any Confidential Information concerning any matter relating to the business or affairs of [the Owner], the Employer or any Associated Employer or any Associated Persons, or of the Employer's suppliers and clients/Customers or those of any Associated Employer which Confidential Information has been acquired by you in the course of your Employment.

## 13. DISCLOSURE OF INFORMATION

13.1 For the avoidance of doubt, nothing in this Agreement shall prevent you disclosing information:

13.1.1 pursuant to any order of any Court of competent jurisdiction; or



13.1.2 which has come into the public domain otherwise than by a breach of confidence by you or on your behalf.

...

## 15. WARRANTIES

### 15.1 You warrant that:

15.1.1 you have made full and frank disclosure to the Employer of all aspects of your conduct which may amount to a material breach of contract or to a material breach of any of the duties of your Employment, including any breach of trust;

15.1.2 you have complied with all your obligations under your Contract of Employment and have not done anything which would have given the Employer grounds to terminate your Employment summarily;

15.1.3 you shall not raise any other grievances or complaints regarding [the Owner], the Employer or any Associated Employer or Associated Persons in relation to your Employment or its termination;

15.1.4 you are not aware of any circumstances which might allow you to pursue a claim against [the Owner], the Employer or any Associated Employer or Associated Persons for personal injury or in relation to accrued pension rights;

15.1.5 at the date of this Agreement, you have not made any complaint against [the Owner], the Employer or any Associated Employer or Associated Persons under the Data Protection Act 1998 and you are not aware of any circumstances which might allow you to make such a complaint;

15.1.6 you will remain bound by the restrictive covenants (Non-Solicitation and Conflicts of Interest) set out in your Contract of Employment;

### 15.1.7 you have not:

15.1.7.1 whether directly or indirectly, spoken to, contacted or been interviewed by any journalist, press, news agency; author, presenter, blogger, vlogger, or reporter about the Grievance; the Tribunal Claim; or any circumstances relating to the complaints set out in the Grievance or the Tribunal Claim; or any story or allegation about discrimination, harassment, bullying or victimisation about or relating to [the Owner] or the Employer or any Associated Employer or Associated Persons; or

15.1.7.2 published or caused to be published, including via social media (either directly or indirectly or instructing or condoning someone to do the same), any article, commentary, video, clip or story relating to; (sic) the Grievance; the Tribunal Claim; or any circumstances relating to the complaints set out in the Grievance or the Tribunal Claim; or any story or allegation about discrimination, harassment, bullying or victimisation about or relating to [the Owner] or the Employer or any Associated Employer or Associated Persons

### 15.1.8 you will not:

15.1.8.1 directly or indirectly speak to, contact or be interviewed by any journalist, press, news agency, author, presenter, blogger, vlogger, or reporter about the Grievance; the Tribunal Claim; or

any circumstances relating to the complaints set out in the Grievance or the Tribunal Claim; or any story or allegation about discrimination, harassment, bullying or victimisation about or relating to [the Owner] or the Employer or any Associated Employer or Associated Persons; or

15.1.8.2 publish or cause to be published, including via social media (either directly or indirectly or instructing or condoning someone to do the same), any article, commentary, video, confirmation, clip or story relating to the Grievance; the Tribunal Claim; or any circumstances relating to the complaints set out in the Grievance or the Tribunal Claim; or any story or allegation about discrimination, harassment, bullying or victimisation about or relating to [the Owner] or the Employer or any Associated Employer or Associated Persons;

15.1.9 ...

15.1.10 you will irretrievably delete your Grievance and any documents or evidence relating to your Grievance (in all cases in hard and soft copy).

## 16. LEGAL ADVICE

16.1 You agree and warrant that:

16.1.1 as well as the Adviser, you have also been advised by ... ('Counsel') in respect of your Grievance, the Tribunal Claim, your Employment and its termination;

...

## 17. CLAIMS

17.1 Having taken advice from the Adviser and Counsel, you confirm that you have or may have the following claims under statute against [the Owner], the Employer or any Associated Employer or any Associated Persons:

- unfair dismissal;
- a statutory redundancy payment;
- an unauthorised deduction from wages;
- a claim for unfair dismissal and/or that you suffered a detriment on the grounds of having made a public interest disclosure;
- equal pay;
- a claim under the Working Time Regulations;
- sexual harassment;
- for direct discrimination, indirect discrimination, harassment and/or victimisation on the basis of sex, race, age, religion or belief, sexual orientation or gender re-assignment;
- for direct discrimination, indirect discrimination, harassment and/or victimisation related to or on the basis of disability or discrimination arising from a disability;
- for failure to comply with a duty to make reasonable adjustments;
- for harassment under the Protection from Harassment Act 1997;
- for failure to comply with obligations under the Data Protection Act 1988

arising from your Grievance, your Employment and/or the termination of your Employment.

17.2 You further confirm that the claims referred to in clause 17.1, together with the Tribunal Claim, a breach of contract claim and any personal injury claim of which you are aware as at the date of this Agreement, are the only claims that you have against [the Owner], the Employer or any Associated Employer or any Associated Persons, arising directly or indirectly out of your Employment or its termination. You hereby waive all such claims and agree that you will not bring further proceedings in the Employment Tribunal, High Court, County Court or otherwise against [the Owner], the Employer or any Associated Employer or any Associated Persons in relation to any such claims.

17.3 You agree to instruct the Adviser to immediately withdraw the Tribunal Claim and allegations in the form of Appendix 2, sending a copy to ... our solicitors, at the same time as you email the withdrawal letter to the employment tribunal (sic), and upon such withdrawal you (the Claimant) agree that the Tribunal Claim falls to be dismissed.

## 18. FULL AND FINAL SETTLEMENT

18.1 You agree to accept the payment of the Tribunal Claim Compensation Sum in full and final settlement of the Tribunal Claim and also the Compensation Sum and the Monthly Compensation Sum in full and final settlement of all or any claims identified by you in clause 17.1 above and any other claims that you have or may have against [the Owner], the Employer or any Associated Employer or any Associated Persons arising under statute (including without limitation the Relevant Legislation), common law, tort, contract or otherwise relating to or arising out of your Employment or its termination excluding any claim for personal injury or any claims against the trustees of the Pension Scheme in respect of accrued pension rights save those you ought reasonably to be aware of at the date of this Agreement.

...

## 20. MISCELLANEOUS

20.1 [The Owner] and the Employer are entering into this Agreement and agreeing to pay the Tribunal Claim Compensation Sum, the Compensation Sum and the Monthly Compensation Sum to you without any admission of liability whatsoever.

20.2 This Agreement constitutes the entire agreement and understanding between the parties and supersedes all or any previous contracts, agreements or arrangements, whether written or verbal between the parties (other than any provision in your Contract of Employment which is expressed to survive termination of the Contract of Employment and which has not been varied by any provision in this Agreement).

..."

30. On 12 October 2018, Mrs A wrote to HMRC to request a refund of the income tax deducted from the Compensation Sum by the Employer in accordance with clause 4.5.3 of the Settlement Agreement. Mrs A wrote:

"I wish to enquire as to whether I should have been taxed in the manner I have, as this does not seem right, given the fact the payment was not related to my employment.

I understand that the employer has fulfilled its obligations to HMRC by initially taxing me for the majority of this payment, but they took it upon

themselves to attribute a very small portion of the payment to injury to feelings and therefore making the decision that my payment was for employment, when in actual fact it was a payment to prevent me from discussing the situation, as it was tied to an NDA.

The employer made the payment through their processes, but it was payment from an individual who wanted the subject to be kept quiet.”

31. In her self-assessment tax return for the year ended 5 April 2019, Mrs A showed an overpayment of tax in the sum of £467,683.82.

32. On 5 January 2021, following an enquiry into Mrs A’s return, HMRC issued the closure notice which concluded that the Compensation Sum was taxable as a termination payment under section 401 ITEPA and reduced her claim for repayment of overpaid tax from £467,683.82 to £6,136.02. Mrs A appealed the closure notice to HMRC on 7 January 2021. HMRC confirmed the decision contained in the closure notice in a review conclusion letter dated 25 March 2021.

33. On 13 April 2021, Mrs A lodged a Notice of Appeal with the FTT against that closure notice on the ground that the Compensation Sum was not chargeable to tax.

#### **RELEVANT LEGISLATION**

34. ITEPA charges income tax on employment income which includes earnings and any amount treated as earnings.

35. Section 225 ITEPA is headed “Payments for restrictive undertakings” and materially provides:

“(1) This section applies where—

(a) an individual gives a restrictive undertaking in connection with the individual’s current, future or past employment, and

(b) a payment is made in respect of—

(i) the giving of the undertaking, or

(ii) the total or partial fulfilment of the undertaking.

(2) It does not matter to whom the payment is made.

(3) The payment is to be treated as earnings from the employment for the tax year in which it is made.

(4) Subsection (3) does not apply if the payment constitutes earnings from the employment by virtue of any other provision.

...

(8) In this section “restrictive undertaking” means an undertaking which restricts the individual’s conduct or activities.

For this purpose it does not matter whether or not the undertaking is legally enforceable or is qualified.”

36. Chapter 3 of Part 6 of ITEPA is headed ‘Payments and Benefits on Termination of Employment etc’ and includes section 401 ITEPA which, in so far as relevant, provides as follows:

“401 Application of this Chapter

(1) This Chapter applies to payments and other benefits which are received directly or indirectly in consideration or in consequence of, or otherwise in connection with -

(a) the termination of a person's employment,

...

by the person, or the person's spouse or civil partner, blood relative, dependant or personal representatives.

(2) Subsection (1) is subject to subsection (3) and sections 405 to 2414A (exceptions for certain payments and benefits).

(3) This Chapter does not apply to any payment or other benefit chargeable to income tax apart from this Chapter.

..."

37. Section 403(1) ITEPA creates the charge to tax on the payment or other benefit. It provides:

"403 Charge on payment or other benefit where threshold applies

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

(2) In this section "the relevant tax year" means the tax year in which the payment or other benefit is received."

38. There was no dispute that the Compensation Sum fell within section 403 if it was a payment within section 401(1)(a).

39. Section 406(1) ITEPA allows for an exception for death or disability payments and benefits, and provides that:

"406 Exception for death or disability payments and benefits

(1) This Chapter does not apply to a payment or other benefit provided -

(a) in connection with the termination of employment by the death of an employee, or

(b) on account of injury to, or disability of, an employee.

(2) Although 'injury' in subsection (1) includes psychiatric injury, it does not include injured feelings."

#### CASE LAW

40. The parties referred us to the following cases on the interpretation of section 401 ITEPA:

(1) *Crompton v HMRC* [2009] UKFTT 71 (TC)

(2) *HMRC v Colquhoun* [2011] STC 394

(3) *Moorthy v HMRC* [2014] UKFTT 834 (TC) ('*Moorthy FTT*')

(4) *Moorthy v HMRC* [2016] STC 1178 ('*Moorthy UT*')

(5) *Moorthy v HMRC* [2018] EWCA Civ 846, [2018] STC 1028 ('*Moorthy CA*')

(6) *Mathur v HMRC* [2022] UKFTT 88 (TC) ('*Mathur*')

41. It is not necessary to discuss the cases in detail as each turns on its specific facts. As Henderson LJ observed in *Moorthy CA* at [49],

"... cases of the present type are very fact-specific, and what matters is always the application of the statutory language in section 401(1)(a) to the facts found in the particular case."

42. There are some comments in the cases, however, which provide useful guidance on the proper interpretation of section 401 and how the tribunal should approach cases in which its application is in issue.

43. As Henderson LJ held in *Moorthy CA* at [43], approving the comments of the UT in *Moorthy UT* on this point: “The relevant question is always whether there is ‘the necessary connection between the payment and the termination of employment’.” That is the only test, as Henderson LJ made clear in [46]:

“... it does not matter that the payment was made to Mr Moorthy after his employment had ceased to exist, or that it may have been a payment (in whole or part) of a capital nature. Part of the purpose of section 401 ... is to avoid the need for enquiries of that nature, by the simple expedient of deeming any payments which fall within the statutory language to be employment income charged to tax under the provisions of ITEPA 2003.”

44. He explained later in [48] that section 401 is widely drawn:

“The word ‘otherwise’ before ‘in connection with’ shows that the kinds of connection envisaged by the section must be wider than the specific examples given of payments and other benefits received directly or indirectly in consideration or in consequence of the termination of a person’s employment ...”

#### **SUBMISSIONS**

45. In summary, Mrs A’s case in relation to section 401 ITEPA is that the payment under the Settlement Agreement arose from the grievance procedure and her claim in the Employment Tribunal. Accordingly, the Compensation Sum was not received directly or indirectly in consideration or in consequence of, or otherwise in connection with the termination of her employment. Mrs A’s evidence was that she left her job voluntarily and was paid a sum to prevent her discussing her departure and the events leading up to it.

46. Mr Fink submitted that the Compensation Sum was extraneous to the rights and obligations of both employee and employer under the contract of employment. It was not paid to compensate Mrs A for anything relating to her contract of employment or for its termination. The Employer paid Mrs A the Monthly Compensation Sum which was the amount due for the notice period under the contract of employment. He said that Mrs A was not due any financial recompense other than for the notice period which was correctly charged to PAYE and NICs.

47. Mr Fink accepted, when it was put to him, that clause 4.5.3 of the Settlement Agreement states that Mrs A agrees that Compensation Sum falls within section 401 although he maintained that was not determinative.

48. Mr Fink contended that the Compensation Sum was paid to ensure that the Employment Tribunal case did not take place and to silence Mrs A so that the underlying issues never became public. In closing, he submitted that the amount of £1,055,000 was wholly related to the confidentiality and non-disclosure obligations in clauses 9, 11, 12, 15.1.7, 15.1.8 and 15.1.10 because, commercially, what the Owner wanted was to ensure the grievance, the ET claim and the Settlement Agreement were never made public. The size of the Compensation Sum reflected the damage that an appearance before an Employment Tribunal would have caused the Employer and the Owner. He accepted that the confidentiality and non-disclosure obligations were within the definition of “restrictive undertaking” in section 225(8) when read in isolation but argued that the definition should be qualified by adding the words “in connection with her current, future or past employment” from section 225(1) after “restrictive undertaking”. He further submitted that, as the confidentiality and non-disclosure obligations

did not restrict her conduct or activities in relation to any employment, section 225 was not engaged.

49. In short, HMRC submitted that it is clear from the terms of the Settlement Agreement (see clauses 4.1.1 and 18.1) that the Tribunal Claim Compensation Sum of £45,000 was paid to settle the Employment Tribunal proceedings. They contended that clauses 4.1.2 and 4.5.3 show that the Employer paid the Compensation Sum to Mrs A to compensate her for the termination of her employment and to settle any prospective claims she had or may have against the Employer or the Owner relating to her employment or its termination. HMRC contended that the Compensation Sum was, at the very least, paid “otherwise in connection with” the termination of Mrs A’s employment.

50. HMRC contended that, where the parties agreed an explicit carve out for compensation for injury to feelings and aggravated damages in respect of the Employment Tribunal proceedings concerning the alleged pre-termination unlawful conduct and did not calculate the Compensation Sum by reference to any individual claims, it is not open to Mrs A or the FTT to do so retrospectively. Accordingly, the whole of the Compensation Sum (except for the first £30,000) is chargeable to tax.

51. If we accept that all or part of the Compensation Sum was paid in relation to the confidentiality and non-disclosure obligations rather than the termination of Mrs A’s employment then HMRC argue in the alternative that such payment is taxable under section 225.

#### **DISCUSSION**

52. HMRC’s primary case was that the Compensation Sum was taxable under section 401(1) and section 403(1) ITEPA and the parties both dealt with it first in their submissions. However, the logical approach is to consider first HMRC’s alternative argument that all or part of the Compensation Sum is chargeable as a payment for a restrictive undertaking in connection with current, future or past employment and taxable under section 225 ITEPA. The reason is that the charge to tax as earnings under section 225 ITEPA takes priority over the charge to tax as specific employment income under section 401 ITEPA because that section does not apply to payments that are otherwise chargeable to tax (see section 401(3)). If all of the Compensation Sum falls within section 225 ITEPA, it is wholly taxable under that provision and there is no need to consider whether section 401 applies. If, however, the Compensation Sum is not covered or not wholly covered by section 225 then it will be necessary to consider whether it is, wholly or partly, a payment otherwise connected with the termination of Mrs A’s employment and taxable under section 401 ITEPA.

53. In Statement of Practice SP 3/96, HMRC say that they do not regard undertakings in termination agreements to discontinue legal proceedings relating to the employment or reaffirming undertakings given as part of the original terms of the employment as having any chargeable value within section 225 and such payments therefore remain within section 401. If, however, a specific payment is made for an employee’s promise not to pursue claims, which is rare in practice, HMRC consider that the payment is not covered by Statement of Practice SP 3/96 and it will therefore be chargeable to tax under section 225(3). A Statement of Practice is no more than that and does not have the force of law. Accordingly, we disregard Statement of Practice SP 3/96 in determining whether all or any part of the Compensation Sum falls within section 225.

54. At the hearing, Mr Fink submitted that the entire Compensation Sum was consideration for the confidentiality and non-disclosure obligations in clauses 9, 11, 12, 15.1.7, 15.1.8 and 15.1.10 of the Settlement Agreement. That might seem a surprising submission as it would appear to lead to the ineluctable conclusion that the whole amount received by Mrs A is

chargeable to tax under section 225(3). However, Mr Fink contended that sections 225(1) and 225(8) should be read together and interpreted as applying only to undertakings which restrict an individual's conduct or activities in connection with the individual's current, future or past employment. The terms of the Settlement Agreement did not restrict Mrs A's future employment in any way but merely required her not to disclose the facts and circumstances surrounding the grievance and the termination of her employment. Mr Fink submitted that, in such circumstances, the restrictions imposed on Mrs A were not a 'restrictive undertaking' within the scope of section 225. If Mr Fink is right then there is no charge to tax under section 225(3).

55. In relation to their alternative argument that section 225 applies, HMRC stated in their statement of case at paragraph 29 that the part of the Compensation Sum that related to Mrs A agreeing to keep matters confidential was chargeable to tax under section 225. At the hearing, Mr Carey submitted that an agreement not to pursue the Employment Tribunal claim amounts to a restrictive undertaking within the scope of section 225 and the Compensation Sum was paid in respect of that undertaking.

56. We begin by considering the meaning of 'restrictive undertaking' in section 225. We then consider whether the Settlement Agreement contains a restrictive undertaking within section 225 ITEPA. Finally, if there is a restrictive undertaking within section 225 in this case, we consider what was the consideration for the undertaking.

57. Section 225(1) provides that the section applies where an individual gives a restrictive undertaking in connection with the individual's current, future or past employment. Section 225(8) defines 'restrictive undertaking' as an undertaking which restricts the individual's conduct or activities, whether or not the undertaking is legally enforceable or is qualified. Mr Fink submitted that section 225(1) and 225(8) should be read together to the effect that section 225 only applies where an individual gives an undertaking which restricts their conduct or activities in connection with, ie in the course of, their current, future or past employment. We do not accept this reading of section 225. It seems to us that section 225(1) does not qualify the definition of 'restrictive undertaking' in section 225(8). Those provisions must be read as providing that an undertaking which restricts an individual's conduct or activities, whether related to their employment or personal lives, which is given in connection with their current, future or past employment falls within section 225. We do not consider that a restrictive undertaking must relate to the individual's conduct or activities in the course of their employment in order for it to fall within section 225. Any undertaking which restricts the individual's conduct or activities and is given in connection with their employment is within the scope of the section.

58. Both parties agreed that the Settlement Agreement contained restrictive undertakings although they differed as to which clauses constituted the relevant restrictive undertaking or undertakings and, as discussed, Mr Fink contended that the relevant undertaking did not fall within section 225 (which we do not accept). There is no doubt that the Settlement Agreement imposes a number of restrictions on Mrs A's conduct or activities. Such restrictions can be found in clauses 9, 11, 12, 15.1.3, 15.1.6, 15.1.7, 15.1.8, 15.1.10, 17.2 and 17.3. In summary, those clauses restrict Mrs A's conduct or activities by:

- (1) requiring her to keep details of the grievance, the termination of her employment, the Employment Tribunal proceedings and the Settlement Agreement confidential;
- (2) prohibiting her from making any derogatory or detrimental statements about her employment, the Employer or the Owner;
- (3) confirming that the confidentiality obligations and restrictive covenants in her contract of employment will continue to apply;



- (4) prohibiting her from raising other grievances or complaints against the Employer or the Owner;
- (5) limiting her communications with journalists etc and what she can say in published materials including on social media about the grievance, the Employment Tribunal proceedings and any circumstances relating to them or to the Employer or the Owner;
- (6) requiring her to waive all claims arising out of the termination of her employment; and
- (7) requiring her to withdraw the Employment Tribunal proceedings.

59. It is therefore clear that, on our construction of section 225(1) and 225(8), Mrs A has given restrictive undertakings in connection with her employment by the Employer, eg clauses 9.2, 11.1, 12, 15.1.3, 15.1.6 and 17.2, and those undertakings are within the scope of section 225.

60. That leaves the question of what consideration, if any, was paid for the restrictive undertakings in the Settlement Agreement. The question, for the purposes of section 225, is what payment was made in respect of the giving of the undertaking or its fulfilment. Mr Fink contended that the whole of the Compensation Sum was consideration for the confidentiality and non-disclosure undertakings in the Settlement Agreement. HMRC submitted that the Compensation Sum was paid to Mrs A to settle any existing or future claims relating to her employment or its termination that she had or may have had against the Employer or the Owner.

61. Neither party suggested that the Settlement Agreement did not reflect the intention of the parties. It is clear from clause 18.1 that:

- (1) the Tribunal Claim Compensation Sum was paid in full and final settlement of the Tribunal Claim; and
- (2) the Compensation Sum and the Monthly Compensation Sum were paid in full and final settlement of all and any claims that Mrs A had or might have had against the Employer and/or the Owner relating to or arising out of her employment or its termination.

There is no doubt that an agreement not to pursue claims or proceedings is a restrictive undertaking within the scope of section 225.

62. HMRC accept that the Tribunal Claim Compensation Sum was paid for injury to feelings and aggravated damages as a result of the alleged conduct which led to the grievance procedure and Employment Tribunal proceedings. HMRC also accept that the conduct was not connected to the termination of Mrs A's employment and was correctly paid without deduction of tax because it does not fall within the scope of section 401 (as it was not a termination payment) or section 62 ITEPA (as it was not a payment based on financial loss arising from pre-termination unlawful conduct).

63. The Compensation Sum was not paid as damages. It was paid, as Mr Fink submitted, in respect of the restrictive undertaking given by Mrs A that she would not make or pursue any claims against the Employer and/or the Owner relating to or arising out of her employment or its termination. Accordingly, we find that the Compensation Sum is chargeable to tax as earnings from employment under section 225(3).

64. That conclusion is sufficient to determine this appeal but, in case we are wrong, we consider whether the payment was received by Mrs A 'directly or indirectly in consideration or in consequence of, or otherwise in connection with' the termination of her employment and

is therefore chargeable to tax as employment income, to the extent that it exceeds £30,000, under section 403(1).

65. HMRC contend that the Compensation Sum was, at the very least, paid otherwise in connection with the termination of Mrs A's employment. We agree with HMRC that the phrase "otherwise in connection with" set out in section 401(1) is extremely wide in scope (see *Moorthy CA* at [48] quoted in [44] above). The only question that determines whether section 401 applies is whether the payment was directly or indirectly in consideration or in consequence of or otherwise in connection with the termination of a person's employment. Mr Carey cited the comments made by Judge Redston in *Moorthy FTT*:

"Whether or not the payment was also to compensate Mr Moorthy for discrimination, unfair dismissal, injury to feelings, redundancy and/or financial loss is immaterial. It is likewise irrelevant whether or not Jacobs made the payment partly or entirely to protect its reputation. The payment can be any of these things, or all [of] them, but because it is 'directly or indirectly in consideration or in consequence of, or otherwise in connection with' the termination of Mr Moorthy's employment, it falls within ITEPA s 401."

66. We agree. We were also referred to the recent decision of the FTT (which included Mr Barrett who is a member of the panel in this case) in *Mathur*, which involved the application of section 401 ITEPA to facts similar, although not identical to those in this case.

67. The starting point is to consider the contractual position and then consider whether the contractual analysis is called into doubt by any relevant facts. In our view it is clear from the terms of the Settlement Agreement that the payment was, at the very least, in consequence of or otherwise connected with the termination of Mrs A's employment. The preamble (called 'Background') to the Settlement Agreement states that it sets out the arrangements relating to, among other things, the termination of Mrs A's employment. Clause 4.1.2 states explicitly that the Compensation Sum is paid as compensation for the termination of Mrs A's employment. Clause 4.5.3 refers to the amount of the Compensation Sum in excess of £30,000 as taxable as a termination award.

68. There was no evidence to suggest that the position described in the Settlement Agreement was inconsistent with reality. Indeed, in answer to a question from Mr Carey, Mrs A agreed that Compensation Sum related in part to the termination of her employment although she maintained that it was primarily to avoid litigation and consequent bad publicity for the Employer and the Owner. We accept Mrs A's evidence and find that the Compensation Sum was a payment that had more than one purpose. It was consideration for her undertaking not to say anything about the grievance and the Employment Tribunal proceedings but it was also related to the termination of her employment. It may be, as Mrs A said, that the Compensation Sum would not have been paid if she had not agreed to withdraw her claim in the Employment Tribunal and enter into the confidentiality and non-disclosure obligations. That, however, does not mean that the payment of the Compensation Sum was not received by Mrs A directly or indirectly in consequence of or otherwise in connection with the termination of her employment.

69. We accept that the payment of the Compensation Sum under the Settlement Agreement was, in part, consideration for Mrs A entering into the confidentiality and non-disclosure clauses in the Settlement Agreement. However, that additional purpose or effect does not mean that there was no connection with the termination of her employment. It seems to us that the contractual position is clear from the words of the Settlement Agreement and, looking at all the evidence in the round, there was a connection between the payment of the Compensation Sum and the termination of Mrs A's employment. It follows that, if we are wrong to conclude that the Compensation Sum is chargeable to tax under section 225(3), the Compensation Sum

(excluding the amount of £30,000 exempted by section 403(1)) falls to be taxed as Mrs A's employment income under section 403.

70. We have considered whether the Compensation Sum could be apportioned between elements that relate to the termination of Mrs A's employment by the Employer and other elements. In our view, that is not possible in this case. The Settlement Agreement already provides for apportionment between the Tribunal Claim Compensation Sum, the Compensation Sum and the Monthly Compensation Sum. The Compensation Sum is a single, undivided amount. The Settlement Agreement does not provide for any further apportionment of the Compensation Sum and there is no evidence on which such an apportionment could be made.

71. We are grateful to Mr Fink and Mr Carey for their clear and helpful submissions, both written and oral, of the issues in this case.

#### **DECISION**

72. For the reasons given above, Mrs A's appeal is dismissed.

#### **COSTS**

73. This case was allocated to the Complex case category under rule 23 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ('FTT Rules'). Rule 10(1)(c) of the FTT Rules provides that the Tribunal may make an order for costs in such proceedings on an application or of its own initiative. However, as she was entitled to do, Mrs A exercised her right under rule 10(1)(c)(ii) to request that the proceedings be excluded from potential liability for costs. Accordingly, the Tribunal may not make an order for costs under rule 10(1)(c) in this case.

#### **RIGHT TO APPLY FOR PERMISSION TO APPEAL**

74. 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.

**JUDGE GREG SINFIELD  
CHAMBER PRESIDENT**

**Release date: 14<sup>TH</sup> NOVEMBER 2022**