Neutral Citation: [2023] UKFTT 00471 (TC)

Case Number: TC08831

FIRST-TIER TRIBUNAL
TAX CHAMBER

In public by remote video hearing

Appeal reference: TC/2022/11634

INCOME TAX – HICBC – adjusted net income – HMRC assessment on basis that adjusted net income included a severance payment – evidence that a substantial element of that payment was paid on account of disability – section 406(1)(b) ITEPA – HMRC interpretation of Horner v Hasted – EIM13630 and 13637 considered – held that the payment on account of disability was not within adjusted net income – appeal allowed

Heard on: 17 May 2023
Judgment date: 02 June 2023

Before

TRIBUNAL JUDGE NIGEL POPPLEWELL
MR JOHN WOODMAN

Between

NICKY HOWARD-RAVENSPINE

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

The Appellant in person

For the Respondents: Ms Maria Serdari litigator of HM Revenue and Customs' Solicitor's Office

DECISION

INTRODUCTION

1. This decision concerns income tax and whether the appellant is liable to pay £2,501 to HMRC to which HMRC have assessed her for the tax year 2016/2017 on the basis that during that tax year her adjusted net income was more than £50,000, and thus she was not entitled to child benefit of that amount which she had claimed in that tax year.

2. This liability is to the High Income Child Benefit Charge ("**HICBC**").

3. As things turned out, the sole issue of significance on which we were called to decide was whether a payment made to the appellant in that tax year by her employer fell within the disability exemption ("**the disability exemption**") in section 406(1)(b) Income Tax (Earnings and Pensions) Act 2003 ("**ITEPA**").

4. It is our view that the payment does fall within the disability exemption with the result that the appellant's adjusted net income for 2016/2017 was less than £50,000. She was therefore entitled to claim and retain the child benefit for that year and is not liable to the HICBC as assessed by HMRC.

THE LAW

5. There is no dispute about the relevant law which we summarise below.

HICBC

6. By section 681B ITEPA (which was inserted by Finance Act 2012 with effect for child benefit payments made after 7 January 2013) a person is liable to a charge to income tax, the HICBC, for a tax year if:

(1) His adjusted net income for the year is greater than £50,000.

(2) His partner's ("partner" is defined in section 681G) adjusted net income is less than his.

(3) He or his partner are entitled to child benefit.

7. Section 7 Taxes Management Act 1970 provides that if a person is chargeable to income tax, he must notify HMRC of that fact within 6 months after the end of the tax year. But if his income consists of PAYE income and he has no chargeable gains he is not required to notify his chargeability to income tax unless he is liable to the HICBC.

Discovery assessments

8. Section 29 TMA provides:

(1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment—

> (a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or
>
> (b) that an assessment to tax is or has become insufficient, or

(c) that any relief which has been given is or has become excessive, the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.

9. Section 34 TMA provides:

(1) Subject to the following provisions of this Act, and to any other provisions of the Taxes Acts allowing a longer period in any particular class of case, an assessment to income tax, capital gains tax or to tax chargeable under section 394(2) of the Income Tax (Earnings and Pensions) Act 2003 may be made at any time not more than 4 years after the end of the year of assessment to which it relates.

The disability exemption

10. Section 401 ITEPA provides:

(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,

(b) a change in the duties of a person's employment, or

(c) a change in the earnings from 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 414A (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.

(4) For the purposes of this Chapter—

(a) a payment or other benefit which is provided on behalf of, or to the order of, the employee or former employee is treated as received by the employee or former employee, and

(b) in relation to a payment or other benefit—

(i) any reference to the employee or former employee is to the person mentioned in subsection (1), and

(ii) any reference to the employer or former employer is to be read accordingly.

11. Section 406 ITEPA provides:

(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.

THE EVIDENCE AND FINDINGS OF FACT

12. We were provided with a bundle of documents. The appellant gave oral evidence. Oral evidence on behalf of HMRC was given by Officer Owen Bevan. From this evidence we find as follows:

(1) The appellant was employed by Norton Rose Fulbright Services ("**the employer**") for a number of years. She had suffered from ill-health since June 2012. From December 2012 she received benefits under the employer's PHI scheme. The provider of that scheme required the appellant to undertake reasonably regular occupational health consultations. We were shown the consultation report for the consultation on 22 January 2016. That report is also dated 22 January 2016 ("**the occupational health report**").

(2) It became apparent that the PHI provider was reluctant to continue to make regular payments under the scheme and having discussed this with her employer, a meeting subsequently took place between her employer and the appellant at which terms were discussed in connection with the termination of her employment. Those discussions took place over a number of weeks and culminated in a termination agreement dated 18 April 2016 ("**the termination agreement**").

(3) The recitals to the termination agreement record that the appellant had suffered from ill-health since June 2012 and had been in receipt of benefits under the PHI scheme since December 2012. That as a result of the appellant's ill-health the parties had concluded that she was unable to return to her post as an IT testing team leader and was unlikely to be able to do so for the foreseeable future. It went on to record that the parties had agreed to terminate the appellant's employment on the terms of the termination agreement.

(4) The termination agreement goes on to state that the appellant's employment would terminate on 12 September 2003; she would be paid any outstanding accrued salary; she would be paid £12,057.06 in lieu of accrued but un-taken holiday; and the employer would make a severance payment of £93,357 as "compensation for loss of office and termination".

(5) The severance payment was paid subject deduction of such tax as was required by law on the balance of the severance payment in excess of £30,000. There was also a tax indemnity pursuant to which the appellant indemnified the employer for any additional tax which might be payable on the severance payment and which was imposed on the employer.

(6) Having visited HMRC's website and done some research, the appellant came across the disability exemption and on 11 May 2016 wrote to HMRC enclosing a copy of the termination agreement and her contract of employment and asking for a refund of the tax that had been levied on the severance payment.

(7) In response to this letter, on 26 May 2016, HMRC sent to the appellant a form which she could use to "claim back any tax we owe you on a small pension lump sum payment or a Pension Flexibility payment that you recently received".

(8) The appellant completed this form identifying her employer and her taxable state benefits but very little else. She returned that form to HMRC on 2 June 2016.

(9) HMRC's records show that on 12 July 2016 HMRC paid the appellant £13,137.96. It is the appellant's evidence, which we accept, that this was received by her by way of a cheque without any covering letter which might have explained the rationale for that payment. It is also her evidence, which again we accept, that she thought that this was a repayment of the tax that had been overpaid on her severance payment and thus that matter had been resolved.

(10) On 18 November 2019, HMRC issued a nudge letter to the appellant advising her to check whether she was liable to the HICBC.

(11) On 19 November 2019 the appellant contacted HMRC and spoke to Officer Bevan.

(12) Officer Bevan's role in the HICBC unit was to deal with voluntary disclosure.

(13) In that telephone call, the appellant told Officer Bevan of the amount of income she had received during the 2016/2017 tax year which she had recorded on her payslip and asked Officer Bevan to review the letter which she had sent in May 2016 asking for a tax rebate. She went on to explain that having received a cheque ostensibly in response to that letter, she thought that this was an acknowledgement by HMRC that they accepted that her severance pay was medically based and that no tax was due on it.

(14) Officer Bevan realised that this was not a conventional voluntary disclosure and that he required assistance. He did not have detailed experience of HICBC. He did not check the appellant's PAYE records as that was not part of his remit. He was asked by the appellant to escalate the matter to somebody who had greater experience than him, within HMRC, and he did this. It seems that having done it, it fell down a crack within HMRC and no further action was taken as regards an analysis of the severance payment at that time.

(15) We find as a fact that it was on 19 November 2019, during that telephone conversation, that Officer Bevan made his discovery of an insufficiency.

(16) On 14 January 2020 HMRC issued an assessment to the appellant for HICBC of £2501 for the tax year 2016/2017 ("**the discovery assessment**").

(17) The appellant appealed against the discovery assessment on 14 February 2020. On 6 March 2020 HMRC provided their view of the matter letter and offered the appellant a review of their decision. The appellant took up this offer on 6 November 2020.

(18) In the meantime, on 2 September 2020, the appellant sent an email to HMRC attached to which was a letter from the PHI provider stating that "as an alternative to monthly payments we made a one-off payment of £83,907…. In full and final settlement of all future liability in respect of the claim by the [appellant's] absence from work and must be used for the benefit of the employee".

(19) We were shown a letter dated 8 December 2020 sent by the employer to the appellant which was intended to "confirm the breakdown of financial information that relates to the payment of a settlement agreement on 28 April 2016".

(20) The letter goes on to detail the payments made on 28 April 2016 as a result of the settlement agreement as follows:

> £2,347.07 as "**basic salary** (taxed appropriately)".
>
> £12,057.06 as "**holiday pay** (taxed appropriately)".
>
> £426.96 as "**PHI adjustment** (taxed appropriately)".
>
> £83,907 as "**Group Income Protection claim payment** (part of the Severance payment) to settle an ongoing claim under the GIP where the employee met the definition of incapacity (/unable to work) under the policy. (£30,000 tax-free and £53,907 taxed appropriately)".
>
> £9,450 as "**severance payment** (taxed appropriately)".

(21) Although there was no documentary evidence to this effect, it was the appellant's evidence that this letter had been sent to HMRC shortly after she had received it from the employer.

(22) On 16 April 2021, HMRC issued their review conclusion letter which upheld the discovery assessment. In that letter, HMRC set out their view of the disability exemption. They describe it thus:

> "Briefly, for the termination payment to qualify for exemption under section 406(1)(b) ITEPA 2003 it would need to pass the two tests set out in the High Court decision of Hasted v Horner:
>
> 1) there must be an identified medical condition that disables or prevents the employee from carrying out the duties of the employment
>
> 2) the payment must be made on account of that disability and on account of nothing else which means that the facts demonstrate that was the sole motive of the payer.
>
> The Occupational Health report dated 22 January 2016 that you produced satisfies the first test that there was an identified medical condition disabling or preventing you from carrying out the employment duties.
>
> However, the second test that the payment was made on account of that disability and nothing else has not been satisfied. Clause 3.1 of the settlement agreement refers to the payment of £93,357 as the 'severance payment' and describes it as 'compensation for loss of office'. The facts, then, do not support an argument that the termination payment is exempt from tax under s406(1)(b) ITEPA 2003".

(23) On 29 September 2022, the appellant lodged an appeal with the tribunal, which was slightly out of time, but on which point HMRC make no objection.

DISCUSSION

The parties' respective positions

13. HMRC's position as set out in their statement of case is straightforward. Officer Bevan made a valid discovery of an insufficiency of the tax paid by the appellant during his telephone conversation with the appellant on 19 November 2019. The discovery assessment was issued in

time. The appellant's adjusted net income includes the entirety of the severance payment of £93,357 as it was compensation for loss of office thus it was not paid on account of her disability and nothing else. It did not therefore fall within the ambit of the disability exemption.

14. In their statement of case, HMRC set out their interpretation of the disability exemption in the following way:

> "55. The legislation that determines whether a payment made on account of injury or disability is taxable is under section 401 Income Tax Earnings and Pensions Act 2003, section 406(1)(b) of the Income Tax Earnings and Pensions Act (ITEPA) 2003.
>
> 56. The High Court decision in *Hasted v Horner* (67TC439) established two tests that must both be satisfied for the disability exception under s406(1)(b) to apply.
>
> a. First test - There must be an identified medical condition that disables or prevents the employee from carrying out the duties of the employment. Medical evidence confirming the precise nature of the disability must therefore be seen in all cases and it must be clear that the nature of the disability prevented the employee carrying out the specific duties of the employment and;
>
> b. Second test - The payment must be made on account of that disability and on account of nothing else. This means that the facts demonstrate that was the sole motive of the payer. In the typical case the payer will confirm that is so, but the description given by the parties is not determinative if the facts indicate other motives exist".

15. HMRC accept that the occupational health report is evidence that the first of these tests has been satisfied but since section 3.1 of the settlement agreement states that the reason for the severance payment was "compensation for loss of office and termination", it was not paid solely on account of the appellant's disabilities and that "as it cannot be determined whether the severance payment was made solely on account of the appellant's disabilities, the second test cannot be met".

16. The appellant's position is equally straightforward. It is absolutely clear from the evidence that £83,907 of the severance payment of £93,357 was paid on account of her medical condition and thus falls within the disability exemption. It should not therefore be taken into account when computing her adjusted net income for 2016/2017. And in the circumstances her income for that year was less than £50,000 and she is not liable under the discovery assessment.

Burden and standard of proof

17. The burden of establishing that the discovery assessment is a valid in time assessment which has been properly served on the appellant, lies with HMRC. They must establish this to the civil standard of proof, namely the balance of probabilities.

18. The appellant did not mount any serious challenge to the validity of the discovery assessment. We have found as a fact that Officer Bevan made a discovery that there was an insufficiency 19 November 2019.

19. Furthermore, as the appellant mounted no challenge to the validity of the discovery assessment, she cannot rely on the case of *HMRC v Wilkes* [2021] UKUT 150 that the discovery assessment is invalid. The concession provided by s97 Finance Act 2022 can only apply to an appeal made before 30 June 2021 if the appellant had challenged an assessment's validity on the

basis that it related to the discovery of income which ought to have been assessed to income tax but which had not been so assessed.

20. We therefore find that the discovery assessment was a valid in time assessment which was served on the appellant and which properly computed the HICBC for which she was liable on the basis that the severance payment was included in her adjusted net income for 2016/2017.

21. In light of this, the burden now shifts to the appellant to show that the discovery assessment overcharges her. And she needs to establish this on the balance of probabilities. As set out above, it is her position that the discovery assessment does so overcharge her as her adjusted net income, properly computed, is less than £50,000 since it should not include that proportion of her severance payment (namely £83,907) which is attributable to her medical condition.

22. HMRC rely on the High Court decision in *Horner v Hasted* [1995] BTC 343 ("***Horner***"). In Horner Mr Justice Lightman had to consider the interpretation of the predecessor to the disability exemption which was set out in section 188 of the Income and Corporation Taxes Act 1988.

23. He said this:

> "It is clear from the language of s.188 that for the exemption to be available it must be established:
>
> > (1) that the disability alleged by an employee is a relevant disability, that is to say, a total or partial impairment (which may arise from physical, mental or psychological causes) of his ability to perform the functions or duties of his employment; and
> >
> > (2) that the person making the payments does so not merely in connection with the termination of employment (compare the language of the exemption of payment made on the death of an employee) but on account of the disability of the employee. In short, there must be established as an objective fact a relevant disability and as a subjective fact that the disability is the motive for payment by the person making it".

24. We do not believe that HMRC have correctly encapsulated these two points in their manual (the current version is at paragraph 13630 of their Employment Income Manual, and is identical to the text set out in their statement of case in this appeal which we have recited above).

25. For the purpose of this decision, the text which concerns us most is their interpretation of what they consider to be the second test. That test in *Horner* is whether the payer makes the payment "not merely in connection with the termination of employment but on account of the disability of the employee".

26. This is reflected in the manual as "the payment must be made on account of that disability and on account of nothing else".

27. This suggests to us, that HMRC have treated the second test as an "all or nothing" test, and so if the severance payment is made on account of disability but also on account of other matters (as was the case for this appellant) the fact that some part of the payment was made for those other matters means that none of the disability payment qualifies for the disability exemption.

28. The reason we think this is because that is the approach which was adopted by the reviewing officer, and also the approach adopted by the individual HMRC officer who compiled

the statement of case. This was not Ms Serdari, but it was certainly her initial submission that because the disability payment was (in our words) "tainted" as it was a part of a single severance payment which included several components, many of which were not paid on account of disability, that part of the severence payment which was attributable to disability could not, as a matter of law, benefit from the disability exemption.

29. In our view this is not what Mr Justice Lightman was saying is the second test. The legislation needs to be construed purposively, and in our view the purpose of the disability exemption is to exempt from tax any payment which is made on account of a disability, irrespective of whether other payments are being made to the employee as part of the same deal.

30. Clearly if a single payment is being made and it is not clear from the evidence, whether documentary or oral, the purpose for which a payment is made, it is perfectly acceptable for HMRC to deny the disability exemption given that the taxpayer will not have been able to establish that that payment was made on account of disability. But where, as in this case, the appellant has provided compelling evidence that a very significant element of the severance payment was on account of disability, then it is our view that that element benefits from the disability exemption even though the termination agreement states that the severance payment of £93,357 was a single payment paid as compensation for loss of office.

31. To the extent that a taxpayer can establish (and the burden of proof is, as in the case of this appellant, on the taxpayer to establish this) that some element of payment which would otherwise be taxable under section 401 ITEPA falls within the disability exemption, then that element is exempt from tax by virtue of that exemption. It is not an all or nothing situation. Simply because other elements of the payment fall outside the disability exemption does not disqualify those elements which fall within it, from benefiting from that exemption.

32. And interestingly, although this was not pointed out to us at the hearing, HMRC's Employment Income Manual at paragraph 13637 appears to accept this. When dealing with the second condition in *Horner* (as set out at EIM 13630) where a payment has been made for disability, they note that "sometimes the termination agreement may indicate that other issues are also being dealt with. <u>If so an apportionment may be</u> <u>necessary</u>." (Emphasis added).

33. It goes on to say that "Many terminations are dealt with by a compromise agreement and will refer to claims that the employee has made against the employer……. Since the compromise agreement will "settle all claims" it settles those claims and some of them may relate to issues other than disability. <u>It follows that some part of the payment must be apportioned those claims and taxed accordingly.</u>" (Emphasis added).

34. Having reviewed the termination agreement, it seems pretty clear to us that the severance payment, although expressed to be paid as compensation for loss of office and termination (which of course it was) was being made in part at least because of the appellant's ill health. This was then made clear to HMRC by virtue of the information subsequently supplied by the appellant which included the occupational health report, the letter from the PHI provider sent by the appellant to HMRC on 2 September 2020 setting out that £83,907 of the severance payment was paid on account of disability, and the breakdown provided in the employer's letter dated 8 December 2020 set out at [12(20)] above.

35. It is our conclusion that £83,907 of the severance payment benefits from the disability exemption and should thus not be included in the appellant's adjusted net income for the purposes of the HICBC. Her adjusted net income for 2016/2017 was less than £50,000.

DECISION

36. We allow the appeal.

POSTCRIPT

37. As mentioned above, the presenting officer, Ms Sedari had initially submitted that the second *Horner* test was an all or nothing test and that since the severance payment of £93,357 set out in the termination agreement was a single payment albeit including several components, no part of it could fall within the disability exemption. Before lunch, we challenged her on this interpretation. Over lunch she considered the position and took instructions. After lunch she accepted that HMRC's interpretation of the legislation, and its application to this appellant, was not correct and that to the extent that the appellant could demonstrate, as she had done in this case, that a proportion of the severance payment was attributable to her disability, that element should benefit from the disability exemption. She then went on to apologise to the appellant for HMRC's failure to properly consider the evidence in this case, and to have applied the wrong test.

38. Judge Popplewell has on occasion, been critical of HMRC's approach towards taxpayers both before and during an appeal. But credit where credit is due, and in our view considerable credit should be given to Ms Sedari whose apology was absolutely the right thing to do and we commend her for it. It was graciously accepted by the appellant, and we suspect that it will have meant as much (if not more) to her as our decision to allow her appeal.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

39. 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.

NIGEL POPPLEWELL
TRIBUNAL JUDGE

Release date: 02nd JUNE 2023