Neutral Citation Number: [2023] EWCA Civ 1383

Case No: CA-2022-001887

**IN THE COURT OF APPEAL (CIVIL DIVISION)**
**ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)**
**MR JUSTICE ADAM JOHNSON AND JUDGE SWAMI RAGHAVAN**
**[2022] UKUT 196 (TCC)**

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 28/11/2023

**Before:**

**LORD JUSTICE LEWISON**
**LORD JUSTICE NUGEE**
and
**LADY JUSTICE FALK**

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**Between:**

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| **THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS** | **Appellants** |
| **- and -** | |
| **E.ON UK PLC** | **Respondent** |

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**Charles Bradley** (instructed by **HMRC Solicitor's Office and Legal Services**) for the **Appellants**
**Jolyon Maugham KC and Georgia Hicks** for the **Respondent**

Hearing date: 9 November 2023

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# Approved Judgment

This judgment was handed down remotely at 10.00am on 28 November 2023 by circulation to the parties or their representatives by e-mail and by release to the National Archives.

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## Lady Justice Falk:

## Introduction

1. In March 2018 E.ON UK plc ("E.ON"), the well known energy supplier, agreed a memorandum of understanding with unions about proposed changes to its defined benefit ("DB") pension scheme. The changes were intended to reduce the cost to E.ON of operating the scheme.

2. A consultation process followed, and thereafter DB scheme members were invited to agree to the changes in exchange for what the First-tier Tribunal ("FTT") found to be an "integrated package". The package comprised a two year pay deal, a commitment not to make further changes to pension arrangements for five years, certain other commitments (for example in relation to the extent of outsourcing) and a "Facilitation Payment". The Facilitation Payment, unlike other elements of the package, was available only to members of the DB scheme. It amounted to 7.5% of salary, subject to a minimum of £1000. Employees were warned that, if they did not agree to the changes, they would receive neither the Facilitation Payment nor the pay rises.

3. The changes were implemented with effect from 1 April 2019. Prior to that, in November 2018, E.ON paid a total of around £6.48m in Facilitation Payments. After discussion with HMRC, E.ON accounted for tax and national insurance contributions (NICs) on all the payments except one made to a Mr Jason Brotherhood. HMRC determined that the payment to Mr Brotherhood gave rise to £758 of income tax under the PAYE regulations and NICs of £987.07. E.ON appealed to the FTT. HMRC agreed that if E.ON succeeded in its appeal it would repay the tax and NICs in respect of all Facilitation Payments.

4. There are two categories of membership of E.ON's DB scheme, final salary and retirement balance. Mr Brotherhood is in the retirement balance category. The changes to the terms of the two categories differ, but Facilitation Payments were made on the same basis to members of both categories and the agreement with HMRC as to the outcome of the appeal also applies to both categories.

5. The FTT (Judge Anne Redston, [2021] UKFTT 156 (TC)) determined that the payment to Mr Brotherhood was properly subject to income tax and NICs. E.ON appealed to the Upper Tribunal ("UT"), which allowed the appeal ([2022] UKUT 196 (TCC)). HMRC now appeal to this court with the permission of the UT.

## The changes to the DB scheme

6. The UT summarised how the retirement balance category worked, and the changes to it, as follows:

> "8. Before the changes, the Retirement Balance category worked as follows:
>
> (1) *Benefit levels* – A member selected one of five benefit levels, which they could change in April each year: 20%, 25%, 30%, 35% and 40%. The percentage corresponded to the percentage of pensionable pay in that year that was credited as a notional sum to their retirement balance account. So, if for example, as Mr Brotherhood did, 40% was selected, 40% of his pensionable pay was credited.

(2) *Benefits on retirement* – On retirement the member could access the total Retirement Balance, which had been adjusted year on year for inflation in line with RPI, to take a cash lump sum or buy an annual pension.

(3) *Funding* – The provision of Retirement Balance was part employee funded and part employer funded. As regards the employee, pension contributions were deducted from the employee's gross pay at source. The contributions increased every year to reflect the employee's age. As regards employer funding, E.ON paid such contributions as determined necessary by the scheme actuary and underwrote the investment risk.

(4) *Option to top up beyond 40%* – Members who had selected the 40% level could buy additional benefit levels in multiples of 5% up to 100%. Each 5% increment would require a further contribution from the employee. E.ON would fund the balance through its contribution and underwriting of investment risk. Mr Brotherhood did not take up this option. At the time the changes were implemented the option was taken up by 75 members (which was 7% of the total 1,100 Retirement Balance category members).

9. The changes to the Retirement Balance scheme were:

(1) The member contributions for each benefit level increased, apart from the 20% level. The level of increase went up by 1% for each benefit level. The contributions increases ranged from 1% for the 25% level to 4% for the 40% level.

(2) The option to top up above 40% was removed."

7. In addition, the FTT recorded at [46] that inflation adjustments would in the future be based on CPI rather than RPI. However, it is common ground that the employer had the right to effect this change, such that the Facilitation Payment is not to any extent attributable to that element.

8. As regards the final salary category, the FTT had noted at [8] that it only had jurisdiction to hear the appeal concerning the payment to Mr Brotherhood, and "therefore had no jurisdiction to make findings of fact and law" about payments to final salary members. The UT described the changes to that category as follows:

> "12. Changes were also made to the final salary scheme. In brief the changes introduced a cap on the extent to which salary increases counted towards pensionable pay: none of the increase would count if pensionable pay was above £70,000 p.a., if pay was less than that, the increase was capped at CPI or 3% whichever was lower. The indexation measure and cap applied to pension increases accrued after 1 November 2018 was changed from RPI (capped at 5%) to CPI (capped at 3%)."

9. Importantly, the FTT found that accrued pension entitlements were unaffected. It said this at [88]:

> "The changes did not affect members' accrued pension entitlements. This is clear from the structure of the arrangements, which relate only to future contributions. It is emphasised in the June 2018 consultation document, which was entitled 'Securing our pensions *future*' (emphasis added) and which explicitly stated:
>
> > 'This is not about taking away benefits that you have already built up (accrued) to date, which you have earned, but like many companies we have to look at how we manage future commitments.'"

There is no suggestion that there is any difference in this respect between the retirement balance and final salary categories: see the UT decision at [63].

10. The FTT also found at [69(5)] that some members of the DB scheme left E.ON before the changes took effect but still received a Facilitation Payment. Payment was therefore not conditional on future service.

11. A final observation to make at this stage is that the terms of the legal obligation on E.ON to make contributions to the DB scheme remained unaltered. Both before and after the changes E.ON was obliged to make such contributions as the scheme actuary calculated to be necessary. What altered was its expectation as to the likely future cost of meeting that obligation.

## The charge to tax

12. It was common ground that for present purposes there is no difference in the test to be applied for income tax and NIC purposes to determine the correct treatment of the Facilitation Payment made to Mr Brotherhood. The single question is whether that payment comprised earnings (or remuneration) "from" the employment. In the context of income tax this derives from s.9(2) of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"), which charges to tax "… earnings from an employment". For NIC purposes, s.3(1) of the Social Security Contributions and Benefits Act 1992 ("SSCBA") defines earnings as including "any remuneration or profit derived from an employment" and s.6 SSCBA requires Class 1 contributions to be paid by reference to earnings.

13. Pensions are charged to tax under a separate part of ITEPA from employment income. The primary charge to tax on employment income is contained in Part 2, with other aspects (including benefits in kind) dealt with in Parts 3 to 8. Pensions are charged to tax under Part 9: see in particular ss.566 and 567.

## The Tribunal decisions

14. Before the FTT Mr Maugham KC, for E.ON, submitted that the Facilitation Payment was compensation for the loss of pension rights, and that the House of Lords decision in *Tilley v Wales* [1943] AC 386 provides binding authority that such a payment is not "from" employment. Further or alternatively, the Facilitation Payment was not taxable either under the "replacement principle" established in *Mairs v Haughey* [1994] 1 AC 303, because it replaced a non-taxable sum, or because rather than being "from" employment it was from something else, namely a reduction in pension rights.

15. The FTT rejected each of these arguments. It concluded that the ratio of *Tilley v Wales* did not extend to the expectation of a future pension, as opposed to giving up an existing

right. In doing so it disagreed with a view expressed by Judge Hellier in *Kuehne + Nagel Drinks Logistics Ltd v HMRC* [2009] UKFTT 379 (TC) ("*Kuehne*").

16. The FTT also rejected Mr Maugham's submission that the Facilitation Payment was tax free because it replaced any of: (a) more generous pension payments that would otherwise have been received by Mr Brotherhood; (b) the earnings needed for Mr Brotherhood to make additional contributions to maintain his level of benefits (which would have attracted tax relief); or (c) higher contributions that E.ON would otherwise have made to the DB scheme. The FTT considered that the characterisation most consistent with the facts was that the Facilitation Payment replaced the shortfall in earnings which the employees would experience if they wanted to maintain the same level of benefits, and on that basis it replaced earnings and was taxable as such (paragraphs [120], [123] and [124]). The employee could choose to make higher contributions, which would attract tax relief, but that was a matter for him.

17. In answer to the question of what the Facilitation Payment was from, the FTT concluded at [130] that it was an inducement to provide future services on different terms, referring to Lord Templeman's speech in *Shilton v Wilmshurst* [1991] 1 AC 684, 689.

18. The FTT rejected the argument that the Facilitation Payment was made for a reduction in pension rights. Rather, it was an inducement to provide future services on different terms. The FTT noted in this context that the Facilitation Payment was part of an integrated package that "changed the future relationship between E.ON and the employees" and could not be separated from other elements. Further, it made no difference that the option to purchase additional benefits was entirely removed (paragraphs [131]-[134]).

19. There were four grounds of appeal to the UT, namely: (1) that the FTT had disregarded relevant facts concerning the final salary category; (2) that it had erred in law in relation to the replacement principle; (3) that it had also erred in relation to *Tilley v Wales*; and (4) that it had erred in considering what the payment was "from". The UT correctly noted at [18] that this last point was "ultimately the single fundamental question".

20. In relation to ground 1, the UT concluded at [22] that the FTT merely correctly observed at [8] that it had no jurisdiction to determine the tax treatment of Facilitation Payments made to final salary members. However, the UT later referred to an arguable error of law relating to ground 1 in the form of a failure to take account of relevant facts relating to the final salary category, namely an inability of final salary members to buy their way out of the impact of the changes by making additional contributions (paragraphs [23]-[24] and [85]-[86]).

21. The UT rejected ground 2, concluding that the replacement principle was a tool of varying utility rather than an overarching principle, that there was no error of law in the FTT not deploying it and that in any event the FTT's view that the Facilitation Payment replaced earnings was "defensible", albeit that it would also have been open to it to analyse the payment as a replacement of employer contributions (paragraphs [34]-[45]).

22. The UT found ground 3 to be made out on the basis that the FTT had read the ratio of *Tilley v Wales* too narrowly. It was not limited to a loss of accrued pension rights but extended to sums paid in respect of a "diminution in the practical value of expected future benefits" (paragraph [62] and, generally, paragraphs [56]-[67]).

23. The UT also allowed the appeal on ground 4. Although the FTT had made a finding of evaluative fact, it was arrived at on the basis of a legal misapprehension in relation to *Tilley v Wales* (as well as to some lesser extent its conclusion on the replacement principle); both retirement balance and final salary members had lost something of value (paragraphs [83]-[90]). The FTT had also erred in treating the fact that the Facilitation Payment was made as part of a package as having the effect that it bore the same tax treatment as the rest of the package (paragraphs [91]-[96]).

24. The UT proceeded to remake the decision. It concluded that the Facilitation Payment made to Mr Brotherhood was not from employment, but rather comprised compensation for adverse changes to rights and expectations in relation to his pension arrangements (paragraph [109]).

## The grounds of appeal and Respondent's notice

25. HMRC's central challenge to the UT's decision was that the UT erred in concluding that *Tilley v Wales* was binding authority for the proposition that a sum paid by an employer to compensate an employee for prospective changes to the accrual of pension rights in the course of the employee's continuing employment – as opposed to a sum paid by an employer to compensate an employee for the loss of an existing right to be paid a pension – is not "from" the employment. As a result, HMRC say that the UT erred in deciding that the FTT was not entitled to reach the conclusion that it did.

26. HMRC's grounds and skeleton argument alternatively maintained that, even if the UT was correct about *Tilley v Wales*, Mr Brotherhood did not suffer even a loss of expectation of pension. However, that was not pursued orally and, given the court's conclusions on the central challenge, I need say no more about it.

27. E.ON filed a Respondent's notice contending that the UT's decision should be upheld for additional reasons, namely: (1) that the FTT erred in respect of final salary members in a way that went beyond the UT's interpretation of what the FTT had done, and this led the FTT into error in its application of the replacement principle and its determination of what the Facilitation Payment was "from"; and (2) that the FTT erred in its approach to the replacement principle. Properly understood the Facilitation Payment replaced contributions that E.ON would otherwise have made.

## *Tilley v Wales*

28. In order to understand *Tilley v Wales* it is first necessary to consider the earlier House of Lords decision in *Hunter v Dewhurst* (1932) 16 TC 605, which was relied on in *Tilley v Wales*.

29. Commander Dewhurst was the chairman of a company who wished to retire from active management of it. Article 109 of the company's articles of association provided that any director who had held office for at least five years and ceased to do so for any reason other than misconduct, bankruptcy, lunacy or incompetence should be paid a sum by way of compensation for loss of office equal to the total remuneration he had received in the preceding five years. Commander Dewhurst had served for at least five years, as had two other directors who both resigned and received a sum in accordance with the articles. However, Commander Dewhurst's other co-directors wanted him to remain on the board. It was agreed that he should resign the office of chairman, receive £10,000 as

"compensation" equivalent to what he would have received pursuant to the articles if he had resigned at that time, remain on the board at a significantly reduced rate of remuneration and waive any future claim under article 109. Subsequently, and without a further request for payment, the other directors resolved to pay an additional £2900 in "full settlement" of any entitlement under article 109.

30. The Court of Appeal decided, reversing Rowlatt J and the Special Commissioners, that the sums paid to all three directors were subject to income tax under Schedule E as profits from their employment. There was no further appeal by the two other directors, but Commander Dewhurst's executors appealed to the House of Lords, who allowed that appeal by a 3:2 majority (Viscount Dunedin and Lord Macmillan dissenting).

31. Lord Warrington referred at pp.643-644 to the "very special circumstances" under which the £10,000 was paid, noting that the "main object" was to relieve Commander Dewhurst of the necessity of regular attendance, in circumstances where unless an arrangement was made his claim under article 109 would diminish each year given the reduced remuneration. The payment was therefore not paid by way of remuneration for past or future services. The £2900 should attract the same treatment. They were "purely capital sums".

32. Lord Atkin also concluded that the £10,000 was neither paid for past remuneration nor for future remuneration, but rather was a sum paid "to obtain a release from a contingent liability under a contract of employment" (p.645).

33. Lord Thankerton similarly characterised the £10,000 as having "formed the consideration for the company's release from their contingent obligations under article 109". It was not a reward for services, future services being separately provided for under the revised arrangement. The £2900 should be treated as having an identical character, neither party having sought to differentiate it. The payments were made for release from the obligations of article 109 and "did not arise from the office of director, but in spite of it". They were not in the nature of income at all (pp.649-650).

34. *Tilley v Wales* concerned a lump sum of £40,000 paid to Mr Tilley by a company of which he was a managing director. The background was that in 1921 Mr Tilley had divulged a secret process to the company in exchange for which it had agreed to pay him a royalty on products manufactured using the process. In 1937 the royalty was replaced by an increase in Mr Tilley's salary to £6000 per annum and an agreement that, in the event that he ceased "from any cause whatsoever" to be managing director, he or his personal representatives would be paid a pension of £4000 per annum for 10 years. By a further agreement in 1938 the parties agreed that the company should be released from its prospective obligation to pay the pension and Mr Tilley's salary would be reduced to £2000 per annum. In exchange, the company agreed to pay £40,000 in two instalments. Mr Tilley appealed against assessments to income tax under Schedule E on those payments.

35. The Special Commissioners discharged the assessments but Lawrence J determined that the £40,000 was taxable, both insofar as it related to the reduction in salary and the commutation of the pension. The Court of Appeal affirmed that decision. By the time the case reached the House of Lords the Attorney General had agreed that the lump sum should be treated as apportionable if the House took the view that tax was due in respect of one element of the compromise and not the other, so it was not necessary to determine

whether the reduction in salary affected the analysis of the pension commutation (see p.394).

36. Viscount Simon, with whom Lord Atkin and Lord Russell agreed, noted that if the pension had been paid it would have been subject to tax under a separate part of Schedule E, as pension. He disagreed with the proposition that the pension was deferred remuneration. Rather:

> "… a pension is in itself a taxable subject-matter distinct from the profit of an office, and, if an individual agrees to exchange his right to a pension for a lump sum, that sum is not taxable under sch. E." (p.392)

Viscount Simon said that this was in accordance with the views of the majority in *Hunter v Dewhurst*, and explained the ratio of that case as being that:

> "… the £10,000 was not a profit from [Commander Dewhurst's] employment as director and did not represent salary, but was a sum of money paid down by the company to obtain a release from a contingent liability as distinguished from being remuneration under the contract of employment." (p.392)

Viscount Simon also expressed the view at pp.392-393 that a payment to commute a pension was capital in nature. In contrast, a sum paid for a reduction in salary was subject to tax.

37. It is worth noting that Viscount Simon's statement of the ratio in *Hunter v Dewhurst* was referred to by Lord Woolf in *Mairs v Haughey* (discussed below) in an obiter section of his speech, in which Lord Woolf commented that he was not persuaded that *Hunter v Dewhurst* was wrongly decided.

38. Returning to *Tilley v Wales*, Lord Thankerton's short concurring speech agreed with Viscount Simon's analysis of the pension commutation element, noting that as in *Hunter v Dewhurst* the payment was made not "from the office of director, but in spite of it" (p.396).

39. Lord Porter also concluded at p.397 that the pension commutation element was not taxable under Schedule E because "it is neither pension nor annuity and comes under no other heading of that section", doubting that much assistance could be obtained by reference to the distinction between capital and income. While he understandably also observed that, bearing in mind that the pension was payable whatever the cause of cessation of employment and was also payable to Mr Tilley's personal representatives, it "looks much more like a payment in lieu of the stipulated reward for revealing the secret process", Lord Porter added that it was unnecessary to speculate on that point. Rather:

> "It is a sum paid for the release of an obligation to provide a pension and it is not shown to be given instead of deferred pay."

### *Mairs v Haughey*

40. *Mairs v Haughey* concerned a payment made to workers at the Harland and Wolff shipyard in Belfast in connection with the transfer of their employment to a new entity on the shipyard's privatisation. The transfer entailed the loss of a generous enhanced redundancy scheme. Mr Haughey worked as a construction manager and agreed, with

other employees, that he would forego his contingent entitlement under that scheme in exchange for a payment equal to 30% of what he would have been paid under it if he had been made redundant. There was also an additional element related to years of service which was held to be a taxable emolument, a conclusion which was not appealed.

41. Lord Woolf, with whom other members of the House agreed, confirmed with reference to *Tilley v Wales* that the Special Commissioners had been entitled to apportion the sum paid between the two elements. That left the issue of whether a payment to give up non-statutory contingent redundancy rights was an emolument. Lord Woolf noted that a payment under an enhanced redundancy scheme would not have been taxable under longstanding Inland Revenue practice and concluded that that practice represented the law, because it compensated the employee for becoming unemployed and was payable following termination of employment on a redundancy, rather than being deferred remuneration.

42. As to the treatment of the payment made to Mr Haughey, Lord Woolf said this at p.319:

> "It is inevitable that if a payment is made in substitution for a payment which might, subject to a contingency, have been payable that the nature of the payment which is made in lieu will be affected by the nature of the payment which might otherwise have been made. There will usually be no legitimate reason for treating the two payments in a different way."

Lord Woolf returned to this at p.323:

> "As already indicated, payment made to satisfy a contingent right to a payment derives its character from the nature of the payment which it replaces. A redundancy payment would not be an emolument from the employment and a lump sum paid in lieu of the right to receive the redundancy payment is also not chargeable as an emolument under Schedule E."

**Discussion**

43. In my view the FTT was correct in its conclusion that it was not bound to apply *Tilley v Wales* to the expectation of a future pension, and its decision discloses no material error of law.

44. The ratio of *Hunter v Dewhurst* has been explained to be that the release of a contingent liability of the kind described in that case was not remuneration. A similar approach was taken in *Tilley v Wales*, where the House of Lords concluded that a lump sum received in exchange for the release of a right to a pension was not taxable as an emolument.

45. The reasoning in *Tilley v Wales* has a significant similarity to that in *Mairs v Haughey*. Viscount Simon's reasoning relied on the fact that pensions were (and are) taxed separately from earnings. *Mairs v Haughey* developed the theme that the tax treatment of a payment made in lieu of a contingent liability will usually be affected by – and in that case was determined by – the tax treatment of a payment made in accordance with its terms.

46. In both *Hunter v Dewhurst* and *Tilley v Wales* the employing company had an existing liability to pay a sum or sums, contingent only on the taxpayer leaving office and (in the case of Commander Dewhurst) doing so other than in prescribed circumstances. In that sense they were accrued rights. That is very different from the facts of this case. In my view it would be wrong to describe the changes to E.ON's DB pension scheme as affecting either accrued or even contingent rights. The FTT found that accrued pension entitlements were unaffected: see [9] above. What was affected was pension benefits related to <u>future</u> service with E.ON. The FTT was correct to describe this in terms of an expectation of a future pension rather than giving up any existing right, contingent or otherwise. E.ON's DB scheme would simply become less attractive for the future.

47. While accepting during oral submissions that the ratio of *Tilley v Wales* was restricted to sums paid in commutation of accrued pension rights, Mr Maugham submitted that it was authority for a broader principle. I do not agree. The FTT was not bound by *Tilley v Wales* to conclude that the Facilitation Payment was not from employment. It was entitled, and indeed in my view correct, to conclude on the facts that it was. It follows that I respectfully disagree with the observations of Judge Hellier in *Kuehne* at [82] and [86] to the effect that the removal of an expectation of a pension should be treated in the same way as a sum paid in exchange for a vested pension right. (*Kuehne* was the subject of appeal to the UT and Court of Appeal but the point did not arise again: [2012] EWCA Civ 34, [2012] STC 840.)

48. I also agree with the UT that the FTT made no error of law in relation to the so-called "replacement principle" derived from *Mairs v Haughey*. It bears emphasis that there is a single statutory question: whether the amount in question is earnings "from" employment. As Chadwick LJ said in *EMI Group Electronics Ltd v Coldicott* [1999] STC 803 at p.819, it is "not necessarily helpful to press the 'replacement' principle too far in this field, where fine distinctions abound". The present case is a good illustration of its limits. Unlike the payment in *Mairs v Haughey*, it is far from obvious what the Facilitation Payment replaced. In contrast, *Tilley v Wales* could be regarded as reflecting that principle, not by according the lump sum the same tax treatment as the pension it replaced, but by its tax treatment being sufficiently coloured by the nature of what it replaced to prevent it being treated as "from" employment. But it is not now even being suggested that the Facilitation Payment replaced actual pension payments as in *Tilley v Wales*. Rather, Mr Maugham submitted that it replaced employer contributions.

49. As it happens, I am inclined to agree with the FTT's observation that, if it was necessary to apply the replacement principle (which in my view it is not), the alternative that is best reconciled with the facts would be that the Facilitation Payment replaced the lower earnings that would be suffered in order to maintain the same level of benefits. More relevantly, however, the FTT was entitled to reach that view, as the UT found. I also do not consider that it makes any difference if account is taken of the fact that final salary members could not "buy their way out" of the changes by making additional contributions, as argued in the Respondent's notice. Those employees would still suffer lower earnings if they sought to supplement their future pension provision through another mechanism, such as additional voluntary contributions (AVCs) or personal pensions.

50. Further, I agree with Mr Bradley, for HMRC, that even if E.ON's preferred approach of concluding that the Facilitation Payment replaced employer contributions were applied (which is not straightforward given E.ON's unchanged legal obligation: see [11] above),

it does not follow that it would necessarily assist its case. Employer contributions to a registered pension scheme benefit from express exemptions from income tax as earnings and taxable benefits (under ss. 307 and 308 ITEPA). We heard no detailed submissions on the point, but it would be by no means clear that a payment to an employee that is regarded as replacing such contributions should attract a similar exemption.

51. As previously noted, the FTT also commented that the Facilitation Payment could not be separated from other elements of the package. The FTT was clearly entitled to find as a fact that the Facilitation Payment was part of an integrated package. In my view it would be wrong to treat that fact as irrelevant, if only because the other elements of the package serve to emphasise the forward-looking nature of what was agreed. The package related to the rewards and benefits of future employment with E.ON. It was an inducement to work willingly for the future. There are numerous occasions on which such inducements have been found to be taxable as earnings, of which *Shilton v Wilmhurst* is a well-known example. Indeed, *Kuehne* is another example (see the judgment of Mummery LJ in the Court of Appeal, at [44]). The UT was also correct to point out at [98], with reference to *Laidler v Perry* [1966] AC 16, that a payment is not prevented from being a taxable inducement to provide future services by not being conditional on the employee remaining in employment.

52. The Facilitation Payment recognised that, so far as those in the DB scheme were concerned, the value of one of the benefits available would be lower for the future than it had been in the past. Insofar as there was an arguable error in not addressing the fact that the Facilitation Payment, unlike other elements of the overall package, was paid only to DB scheme members such that it could properly be distinguished from other elements, that error is not material. It is clear from the FTT's decision at [11] and [131] and the references there to "moreover" that the FTT's comments about the effect of the package were not an essential part of its reasoning in dismissing the appeal.

## Conclusion

53. In conclusion, I would allow HMRC's appeal and remake the UT's decision by dismissing the appeal against the FTT's decision.

## Lord Justice Nugee:

54. I agree, and I am grateful to Falk LJ for setting out the position so clearly.

55. An employer offers its employees a number of benefits. It decides that one of them is too expensive, and wishes to reduce the cost of providing it. Rather than seeking to force this change on its employees, it invites them each to agree to the change. In return for such agreement it offers them a package of incentives, including guaranteed pay rises and a one-off cash payment. The question is whether the cash payment is subject to income tax and NICs. That depends on whether it is "from employment".

56. In the absence of authority I would have thought the answer to that question was straightforward. The employees are being asked to agree to a change in the terms on which they might be employed in the future, and in return receiving a payment in money. The payment seems to me plainly to have come from their employment. One can compare *Bird (Inspector of Taxes) v Martland* [1982] STC 603 (not cited to us, but referred to by Newey J in *Kuehne* in the Upper Tribunal [2010] UKUT 457 (TCC) at

[60]). There cash payments had been made to employees whose subsidised company cars were withdrawn, and Walton J had no hesitation in holding that the only possible conclusion was that they were taxable emoluments.

57. In the present case the relevant benefit, offered to certain of E.ON's employees, was membership of a defined benefit (or DB) pension scheme. Like other DB schemes this provides for the employee members to make certain contributions to the scheme and for the employer to pay the balance of the cost of the benefits. The effect of this is to put the risk of such matters as investment performance on the employer. Like many other employers have done, E.ON decided to reduce the risks involved in their DB scheme by reducing the cost of future accrual. This can in principle be done by increasing employee members' contributions or reducing the value of future accrual or both. What E.ON in fact did (in the retirement balance category) was to offer a choice to the members, the effect of which was that they could either stay on the same level of benefit, paying in most cases more for their benefits, or, if they wished to pay less, move to a lower level of benefit. The changes to the final salary category were rather simpler, consisting of restrictions on future pensionable pay.

58. Does it make a difference that in the present case the cash payment was in connection with this change to the terms of the pension scheme going forward? In principle I do not see why it should. In the FTT Mr Bradley's submission was that the Facilitation Payment was "compensation for a change to the conditions of employment going forwards". Judge Redston accepted this submission (at [130]), saying that the payment was:

> "in exchange for the employees in the retirement balance scheme agreeing to a change to their future terms of employment. It was thus "from" employment within the normal meaning of the term."

I agree. The UT took a different view, saying (at [96(1)]) that the FTT discounted the adverse changes to pension arrangements as a possible source for the Facilitation Payment, and concluding (at [109]) that the payment to Mr Brotherhood was:

> "compensation for the adverse changes being made to rights and expectations in relation to his pension arrangements."

59. The difficulty I have with this is that this is presented as an alternative to the FTT's conclusion that the payment was made in exchange for the relevant employees agreeing to a change in their future terms of employment, as if they were mutually exclusive. But that seems to me a false dichotomy. I do not see any reason to doubt that the payment was made as compensation for the adverse changes to the pension scheme going forwards, not least because it was only paid to the members of the DB scheme. But this is no more than another way of saying that it was paid as an inducement to the members to agree to a change in their future terms of employment, the relevant change being the adverse change to the DB scheme. So to say that the payments were compensation for the adverse changes being made to the pension scheme or in exchange for agreeing to a change in future terms of employment is not to my mind to say two different things, but is to say the same thing in two different ways.

60. That leaves the question whether there is anything in the authorities which requires a different answer. On this I agree with the compelling analysis of Falk LJ above. Specifically:

(1) The ratio of *Tilley v Wales*, as Mr Maugham accepted, goes no further than that a sum paid in commutation of accrued pension rights is not taxable as earnings from employment. (It may be noted, as Falk LJ refers to at paragraph 34 above, that the pension in that case was originally awarded to Mr Tilley in lieu of a royalty payable to him on a secret process which he had invented, and that in the House of Lords the Crown appears to have not even persisted in the argument that it was deferred remuneration (see per Viscount Simon LC at 392); and Lord Porter at any rate seems to have decided the case on this basis (see at 397)). Be that as it may, I agree with Falk LJ that the case is not authority for any wider principle than the ratio which Mr Maugham accepted, and does not apply to the present case where the relevant employees were not being asked to exchange any existing accrued rights for cash.

(2) *Hunter v Dewhurst* is a difficult case and had we been free to do so I would myself have thought the dissenting speeches of Viscount Dunedin and Lord Macmillan more persuasive than the three speeches of the majority, in which it is not entirely easy to find a single ratio. But in *Tilley v Wales* Viscount Simon said that the ratio was that the payment to Commander Dewhurst was not a profit from his employment but "a sum of money paid by the company to obtain a release from a contingent liability" (see at 392), and we are I think bound to accept that as an authoritative statement of what the ratio is. Nevertheless I agree with Falk LJ that the payment here was not a payment "to obtain a release from a contingent liability". Mr Brotherhood's future pension rights were not an existing liability, contingent or otherwise. They were rights yet to be earned, and would only be earned by future employment.

(3) On *Mairs v Haughey* I am content to say that I agree entirely with Falk LJ.

61. In these circumstances I consider that the FTT was entitled (and indeed right) to come to the conclusions that it did, and I agree that the appeal should be allowed as Falk LJ proposes.

**Lord Justice Lewison:**

62. I agree with both judgments.