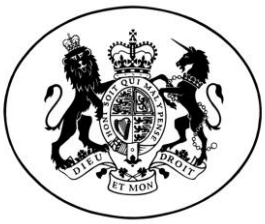
[2019] UKFTT 0473 (TC)



TC07276

Appeal number: TC/2017/01711

INCOME TAX – termination payment or relevant benefit under EFRBS – disability-entire agreement clause-extrinsic evidence-late amendment of grounds of appeal-no-appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

THE EXECUTORS OF IAN JOHN CLARK (deceased) **Appellants**

- and -

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

TRIBUNAL: JUDGE ANNE SCOTT

Sitting in public at George House, 126 George Street, Edinburgh on Wednesday 6 and Thursday 7 June 2018

Mr Andrew Thornhill, QC, for the Appellant

Mr Ross Anderson, Advocate, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

The issue

1. The appeal relates to a Closure Notice issued by the respondents ("HMRC") on 1 July 2016 under Section 28A(1) and (2) of the Taxes Management Act 1970 ("TMA") whereby HMRC concluded an enquiry opened into the 2013/14 self-assessment tax return of the late Ian John Clark brought under Section 9A TMA. The appeal is brought by Mr Clark's executors.

2. The Closure Notice refused the appellants' claim for relief under Section 406 Income Tax (Earnings and Pensions) Act 2003 ("ITEPA") and amended the self-assessment tax return increasing the self-assessment by £7,054,025.65 from an overpayment of £7,052,720.65 to an underpayment of £1,305.20.

3. On 27 December 2013, what was described in Mr Clark's self-assessment tax return for 2013/14 as "Termination Payment 31 December 2013-£15,705,613" had been remitted to him under deduction of PAYE ("the Payment"). In fact, the total consideration paid to him under a Settlement Agreement was £18 million but there is no dispute about the tax treatment of £2,294,387 which was received as salary and revenue related income to 31 December 2013.

4. Mr Clark has been fully remunerated for the services that he has carried out for his employer and there is no suggestion by either party that the Payment had been made to compensate him for past services. Equally there is no suggestion that the Payment was made in respect of future services.

5. The dispute between the parties is limited to which provisions of Part 6 of ITEPA apply to the Payment.

6. HMRC have conceded that, because prior clearance for PAYE purposes was granted on the basis that the Payment was taxable under section 401 ITEPA (which includes the £30,000 exemption under section 403 ITEPA), if they are successful in arguing that section 401 is not applicable, then nevertheless the first £30,000 of the Payment does not fall to be assessed.

7. The appeal was lodged late but HMRC have not objected and I therefore formally extend the time for lodging a Notice of Appeal.

The Grounds of Appeal

8. In the Notice of Appeal the appellants sought repayment of tax deducted under PAYE on two alternative bases:

> (1) If the payment falls within section 401 ITEPA ("section 401"), £3,595,000 is exempt in terms of section 406 ITEPA ("section 406") as representing that part of the termination payment that was made on account of Mr Clark's disability. A repayment is therefore due in respect thereof.
>
> (2) The entire payment was made in return for the surrender of pension rights and thus it falls outside section 401 since it was not made in connection with Mr Clark's employment. It falls outside section 394 ITEPA ("section 394") as it does not constitute relevant benefits within the meaning of section 393 ITEPA ("section 393"). Accordingly the whole amount of the tax deducted, £7,052,720 is repayable.

9. The appellants' Skeleton Argument (described as a Statement of Case) dated 15 May 2018 stated: "Admittedly, there was here a scheme to provide 'relevant benefits'. However, the relevant payment was not a benefit provided under a scheme (see s.393 (1). It was a payment for giving up benefits and as such not liable to income tax or capital gains (TCGA s.144 (a))".

10. The argument on section 144 was not pursued in Closing Submissions at the hearing and Mr Thornhill argued then that section 393 was relevant and not section 401. He then changed his mind and also advanced arguments on section 401. Since the legislation fell to be considered in any event, I listened to all arguments on its applicability.

11. That Skeleton Argument stated at paragraph 3:

> "The first task facing the Tribunal is to apportion the sum paid between (a) termination of employment, and (b) surrender of pension rights first on the part of Mr Clark and second of Mrs Clark."

at paragraph 4:

> "It is submitted that whatever sum is attributed to Mr Clark's loss of earnings falls within s.406 for the simple reason that it was his illness (disability) which occasioned the termination."

and at paragraph 5:

> "5. The balance relates to the loss of pension rights. Some part of those rights must relate to Mrs Clark. She is not a party to this appeal and accordingly that part should be taxed, if at all, on her and not Mr Clark. The evidence of Mr Bartlet will assist the Tribunal to quantify what sum is attributable to the surrender of Mrs Clark's pension."

12. On the first day of the hearing I asked Mr Thornhill if he wished to amend his Grounds of Appeal since he had not applied to expand or alter the Grounds of Appeal and no argument had previously been advanced in relation to Mrs Clark. He declined.

13. In his response to Mr Anderson's Reply to his Closing Submissions, Mr Thornhill applied for leave to amend the Grounds of Appeal and then to recall Mr Bartlet to

give further evidence. Understandably, Mr Anderson vigorously objected. Both applications were refused. The detail is set out in the Footnote to the Decision.

HMRC's Position

14. HMRC contend that the appeal should be refused because the Payment is an amount which counts as employment income in terms of Part 6 ITEPA:

(a) There is no evidence that any part of the Payment was provided on account of disability in terms of section 406; and

(b) The Settlement Agreement was itself an Employer-Financed Retirement Benefits Scheme ("EFRBS") in terms of section 393A and the Payment was a lump-sum payment made under that EFRBS in terms of section 393B(1).

15. HMRC argued that the approach should be:-

(a) First, to consider whether the Settlement Agreement was itself an EFRBS in terms of which the Payment constituted a relevant benefit for the purposes of section 393B.

(b) Second, and in the alternative, in the event that the Tribunal is not persuaded that all or part of the Payment constituted a "relevant benefit" under an EFRBS, HMRC submit that any part of the Payment which is not a relevant benefit under an EFRBS should be considered to be a termination payment under section 401; and that there is no basis for applying the exemption contained in section 406 for a payment provided on account of disability.

(c) If the appellants fail to satisfy the Tribunal that all of the Payment was made on account of disability then insofar as the appeal sought repayment of tax it must fail.

The evidence

16. Although the appellants' Skeleton Argument pointed out a number of areas where the appellants argued that the Tribunal would require evidence there was a distinct paucity of relevant evidence, particularly in relation to Mr Clark's disability and intentions in regard to work.

17. The Tribunal heard from Mr Kilshaw, Mr Clark's family solicitor, and Mr Laurie, his tax adviser. In addition, Mr Bartlet, an actuary instructed by Mr Laurie (but who had also worked for Mr Clark's then employer) spoke to his calculations as to:

(a) the amount of the Payment that should be attributable to disability, and

(b) what proportion of the Payment would have been attributable to the loss of earnings for the additional years of assumed work had Mr Clark not been ill.

Those calculations were instructed and prepared years after Mr Clark's death.

The Applications

18. At the outset of the hearing, Mr Thornhill lodged:

(a) an interest statement for 2013/14 relating to a bank account (no 12791642) in the joint names of Mr and Mrs Clark. It was unsupported by any other evidence, and

(b) copy e-mails relating to Mr Bartlet's engagement by Mr Laurie and Mr Clark's employer's provision to him of their calculation of the Payment.

Mr Anderson objected to the late lodgement.

19. After having heard all of the oral evidence, on the afternoon of the first day, Mr Thornhill then applied to lodge in evidence copies of two letters from the Royal Bank of Scotland and a bank statement for account 21177329 in the joint names of Mr and Mrs Clark, both of which had been provided by Mr Kilshaw.

20. Mr Anderson again objected. It was clear that in both instances the purpose of the lodgement was to support an argument that had appeared for the first time in the appellants' Skeleton Argument to the effect that some part of the Payment was attributable to Mrs Clark (see paragraph 11 above). I again asked Mr Thornhill if he was applying to amend his Grounds of Appeal and he again stated that he was not doing so.

21. After debate, on each occasion, the documents were admitted *de bene esse*. The detail in relation to these adminicles of evidence is set out in the Footnote to the Decision. Ultimately the documents were admitted in evidence but, as can be seen below, they were of very little weight.

22. In his Closing Submissions, Mr Thornhill intimated that he wished to "change tack" and look at Mrs Clark's pension surrender. Mr Anderson addressed that issue reluctantly, and effectively under protest, in his Closing Submissions. In his Reply Mr Thornhill sought leave to amend his Grounds of Appeal. That application was refused.

23. The detail of the applications and the reasons for my decisions thereon are set out in the Footnote to the Decision.

The Decision

24. The appeal is dismissed on the basis of the findings in fact and reasons for the decision set out below.

25. I have set out the facts that I have been able to find and the arguments canvassed at length not least because Mr Thornhill stated clearly that he intended to appeal my decision not to permit him to amend his Grounds of Appeal.

The Facts

26. Mr Clark was one of the three founders of Walter Scott & Partners Limited ("the Company") which was sold in 2006. He had been employed as Investment Director

since 1 January 1983 and remained with the Company after the sale until he retired. (The other two founders only remained as directors for a short period after the sale.)

27. His responsibilities were focussed on Investment Management Services and Research. He enjoyed mentoring staff.

28. He was born on 23 August 1948 and died on 27 February 2015. There is no evidence as to the cause of his death.

29. In a letter to HMRC, dated 25 February 2014, the Company stated that "Mr Clark's arrangement commenced in 2001 but was not formally documented until October 2006." No evidence has been provided as to what arrangement existed prior to 2006.

30. However, it is the case that on 16 and 17 May 2006, Mr Clark and the Company entered into a Service Agreement.

The Service Agreement and his employment

31. The key provisions include:

(a) Clause 4 (a full copy of Clauses 4.3 and 4.4 are annexed at Appendix 1) provided that:

i. Mr Clark's remuneration would be a basic annual salary that was equal to a percentage of the fees received by the Company in each financial year (4.1).

ii. Following the termination of his employment, however occasioned, until the date of his death, he would receive exactly the same amount (4.3).

iii. From the date of his death until such time as his surviving spouse died, that spouse would be entitled to an amount that is equal to half that percentage of the fees received by the Company (4.4).

(b) Clause 7 confirmed that Mr Clark was not a member of, nor eligible for, the Company pension scheme.

(c) Clause 10.6 provided that on termination of his employment for whatever reason he must resign as a director without any claim for compensation.

(d) Clause 10.7 provided that termination of his employment would not affect either his, or his surviving spouse's, rights in terms of Clauses 4.3 and 4.4.

(e) Clause 11 provided that the Company's normal retirement age is 65.

32. That Service Agreement was amended, with effect from 1 April 2007, whereby the percentage of fees referred to in Clause 4 was significantly reduced. There was no other relevant amendment.

33. Mrs Clark was not a party to either the original or the amended Service Agreement.

34. Mr Clark retired as an Executive Director of the company on 30 September 2009 but continued as a Non-executive Director. In a letter dated 7 May 2015, Mr Laurie confirmed that the change in status was for Financial Services Regulatory reasons.

35. In the letter to HMRC dated 25 February 2014, the Company stated that Mr Clark continued as a Non-executive Director until 31 December 2013. In fact, the date of resignation as a Director was 1 February 2013 as intimated to Companies House and reported in the Statutory Accounts for the year ended 31 December 2013.

36. Mr Clark's status in the Company between 1 February 2013 and 31 December 2013 is unknown. Mr Kilshaw said that he stopped work on 13 December 2013 but Mr Laurie said that it was on 31 December 2013.

37. The only other oral evidence on that was furnished by Mr Laurie who said that the visits to him by staff or directors of the company (see paragraph 42 below) had become progressively less frequent and that that had disappointed Mr Clark.

38. In terms of Clause 4.2 of the Service Agreement Mr Clark was paid quarterly in arrears. His revenue related remuneration for the first quarter of 2013 was paid in the normal course of events on 26 April 2013. The next payment would have been due in or around July 2013.

39. In the letter of 7 May 2015 to HMRC, Mr Laurie stated that the payments for the remaining quarters of 2013 were "put on hold" whilst there were discussions about the quantum of the Payment.

40. The Settlement Agreement provided that remuneration for those three quarters, amounting to £1,310,791, was to be paid within 28 days of 31 December 2013. In fact it was paid on that day.

Mr Clark's health

41. There is very little medical evidence. Prior to the end of 2011, Mr Clark had begun to endure poor health stemming from a debilitating neurological condition. At that juncture he continued to drive to Edinburgh daily and worked full-time but there came a point when he could no longer drive and the Company organised a car and driver for him. That ceased in May 2012 when he was reported to be "generally wheelchair bound". At that point he became physically unable to leave his home and senior employees of the Company would visit him for investment advice and he mentored younger members of staff.

42. A medical report from a Consultant Neurologist dated 7 May 2013, referring to a consultation five days earlier, reported a perceived significant improvement since the beginning of the year but stated that Mr Clark was only able to mobilise with the aid of a zimmer frame. There had been no progression of the disease and it stated: "Cognitively he remains very sharp, and his business colleagues come to discuss business with him every week."

43. By 1 October 2013, that Consultant, responding to a request from Mr Clark, the details of which are unknown, stated:

> "I can confirm that you have a debilitating neurological condition, which has unfortunately prevented you from carrying out your duties of employment in the normal way."

44. His work was cerebral and sedentary in nature and, because of the nature of his illness, had become the one keen interest that remained open to him.

The Settlement Agreement

45. At some point before mid-July 2013, there must have been negotiations about a potential termination of Mr Clark's employment. I say that because his quarterly payment had been put on hold. Certainly, by August 2013, agreement in principle had been achieved and Mr Laurie was advising him on the tax aspects. Mr Kilshaw advised on the employment aspects.

46. The Settlement Agreement was entered into by Mr Clark, his wife and the Company on 13 December 2013 ("the Settlement Agreement").

47. The recital to the Settlement Agreement reads:-

> "The Executive's employment shall terminate by mutual consent on 31 December 2013 and the Company, the Executive and the Executive's Wife desire to settle fully and finally any claims arising out of rights, entitlements and obligations arising under the Service Agreement (as hereinafter defined) and the termination of the Executive's employment."

48. In terms of the Settlement Agreement, the Company agreed to pay Mr Clark £18 million less salary payments and revenue related remuneration due or paid in respect of the 2013 calendar year.

49. Clause 2 provided that his salary would be paid up until 31 December 2013, benefits would be furnished and he would be reimbursed for expenses in the usual way.

50. Clause 2.3 provided that Mr Clark and his wife confirmed that there were no other sums due to either of them or to Mr Clark's other dependents, heirs or successors.

51. Clause 3 of the Settlement Agreement reads as follows:-

> "3.1 The parties are aware that the Executive may have claims of unfair dismissal, breach of contract, and/or a claim for direct or indirect discrimination related to disability, discrimination arising from disability or failure to make adjustments under section 120 of the Equality Act 2010 (the '**Particular Claims**'). Subject to clause 3.2, the Executive and the Executive's Wife accept the Termination Payment in full and final settlement of (i) the Particular Claims and (ii) all and any claims, present, future or contingent, competent to them or the Executive's other dependants, heirs or successors (whether under the laws of testate or intestate succession) or any other claims made on his estate and intimated to his Executors against the Company and/or any Associated Company and any director, officer, employee and agent of the Company and/or any Associated Company arising from his employment and/or the termination of his employment

with the Company and in particular all claims arising from clauses 4.3 and 4.4 of the Service Agreement. Without prejudice to the foregoing generality, this settlement applies to all claims (whether under statute, common law, European law or otherwise) including damages, breach of any contract with the Company (including, without limitation, the Service Agreement), pension or pension rights howsoever arising (other than accrued pension rights), personal injury, redundancy pay, compensation for unfair dismissal, unlawful deduction of wages, loss of office or employment or otherwise.

3.2 This Agreement applies to any claim for physical or psychiatric illness or injury or stress related claims which the Executive has or may have against the Company or any Associated Company, but does not apply to any claim by the Employee relating to accrued pension rights in relation to a Company pension scheme or latent personal injury. However, by signing this Agreement the Executive warrants that he is not aware that he has any basis to claim compensation for personal injury against the Company or any Associated Company."

52. Clause 4.2 of the Settlement Agreement sets out the acknowledgement by the parties that the first £30,000 of the termination payment would not be subject to deduction of income tax or National Insurance Contributions as the termination payment

> "… is a payment to buy out the rights of the Executive and the Executive's Wife under Clauses 4.3 and 4.4 of the Service Agreement and to reflect compensation for loss of employment and compromising all other claims set out in Clause 3….".

53. Clause 4.4 provided that the Company would contact HMRC to seek a ruling from them as to whether it was correct to treat the termination payment as properly chargeable to tax under Chapter 3 of Part 6 of ITEPA and recognised that Mr Clark

> "… intends to contact HM Revenue and Customs to seek a repayment of income tax remitted by the company on his behalf on part of the Termination Payment on the grounds that part of the Termination Payment should not attract income tax by virtue of Section 406 of ITEPA".

54. Clause 5 confirmed that the Company would not meet the costs of professional advice in relation to any claim made by Mr Clark under section 406 ITEPA.

55. Clause 6 provided that both Mr and Mrs Clark renounced any right to litigate in relation to his employment and the termination thereof and in particular to litigate in relation to Clauses 4.3 and 4.4 of the Service Agreement.

56. Clause 9 states that Mr Clark declared that he had received advice from Mr Kilshaw, his solicitor, as to the terms and effect of the Agreement, and in particular about its effect on his ability to take matters to an Employment Tribunal.

57. Clause 12.1 of the Settlement Agreement reads as follows:-

> "**ENTIRE AGREEMENT**
>
> **12.1** This Agreement contains the entire and only agreement between the parties, and both parties acknowledge that, on entering into this Agreement, they have not relied on any written or oral representation or undertaking other than as expressly stated in this Agreement, and that (subject to Clause 11 of this Agreement) this Agreement supersedes any previous contract or arrangement between the parties including, without limitation, the Service Agreement. For the avoidance of doubt, all remaining provisions of the Service Agreement (save as stipulated at

clause 11 of this Agreement) including the provisions of clause 4 (as amended) shall be deemed to be terminated by mutual agreement on the date this Agreement is signed by the Executive and the Executive's Wife.

12.2 This Agreement is without prejudice and subject to contract until it is dated and signed by all of the parties and the Company has received the signed Legal Adviser's certificate annexed to this Agreement, at which point it shall be treated as an open document evidencing an agreement binding on the parties (notwithstanding that it may still be labelled or headed 'Without Prejudice' and/or 'Subject to Contract')."

The Statutory Accounts

58. In the Company's Notes to the Financial Statements at 31 December 2012, the relevant part of Note 23 reads:

"**23. Post retirement liabilities**

The Company has in place an agreement with a Director giving rise to a post retirement benefit.

This agreement is unique to the Director receiving the benefit and there are no other agreements in place similar in nature. An analysis of the liability in respect of the agreement is given below. This is an unfunded arrangement and no assets are held. The arrangement is based on future fee income and there is no current service cost.

An actuarial valuation was carried out at 31 December 2012 by a qualified independent actuary …Life expectancy is assumed to be in line with the standard UK actuarial tables … for males …

Movement in the present value of the post retirement liability

	2012	**2011**
	£	**£**
Estimated liability at 1 January	**27,476,000**	19,629,000
Interest cost – recognised in finance costs	**1,374,000**	1,060,000
Actuarial loss – recognised in statement of total recognised gains and losses	**2,695,000**	6,787,000
Balance at 31 December	**31,545,000**	27,476,000
Related deferred tax asset	**7,255,350**	6,869,000
	24,289,650	20,607,000

59. In summary the accounts record a liability, in respect of a retirement benefit arrangement, of £31,545,000 and an associated deferred tax asset of £7,255,350 recognising the then present obligation for estimated future payments.

60. By contrast the US parent company carried a liability of £15 million in the consolidated group accounts.

61. The same Note in the Financial statements as at 31 December 2013 reported that:

> "The arrangement was settled in 2013 … An analysis of the liability in respect of the agreement is given below … The post retirement liability was settled during the year and thus the retirement liability as at 31 December 2013 was £nil."

62. The reality is that the provision in the accounts for £24,289,650 was released.

The Payment

63. On 27 December 2013, the USA parent of the Company made two payments to Mr Clark, described as "payroll batch control" totalling £9,378,861.60. Those payments were made into an account in the joint names of Mr and Mrs Clark, being the bank account for which a statement was latterly produced by Mr Thornhill.

64. Mr Laurie, who had prepared Mr and Mrs Clark's tax returns, confirmed that all of Mr Clark's remuneration had been paid into a joint account.

65. The termination payment was £15,705,613, and the Company deducted income tax which was remitted to HMRC in or around December 2013.

66. Mr Bartlet's evidence was that the quantum of the termination payment was calculated by reference to the parent company's consolidated accounts prepared in accordance with the US GAAP.

67. I can see from the email correspondence lodged on the first day that Mr Bartlet derived that information from an email from the Company, the salient part of which reads:

> "Dear Mike,
>
> The total settlement was based on US GAAP provision. The agreed amount was £18m which was derived as follows:
>
> | | |
> |---|---|
> | 31 March 2012 | £15,000,000 |
> | 9 months accretion | £ 330,228 |
> | Balance at 31 December 2012 | £15,330,228 |
> | Forecast remuneration 2013 | £ 2,300,271 |
> | Total | £17,630,499 |
>
> Rounded to £18m.
>
> As you will see from the above summary and the attachments the total settlement amount included revenue related remuneration for 2012. I've reconciled back to the £15m balance at 31 March 2012."

68. Mr Bartlet replicated that in the paper he prepared for Mr Laurie in June 2016 (and he referenced it). He described the £15 million as "USGAAP reserve at 31 March 2012" and explained:

> "The USGAAP reserve of £15m at 31 March 2012 was selected by the Company in 2012 from a range of £15m to £30m. The figures in the range were based on variations in:
>
> - Assumed earnings (and their growth)
> - Discount rate (i.e. assumed investment return)
> - Mortality
>
> The USGAAP reserve was a rounded figure, selected from the range and as such there is not a definitive set of assumptions for us to reference to reproduce that rounded figure."

69. The one thing that is certain is that the computation of the Payment by or for the Company was not an actuarial valuation reflecting Mr Clark's own personal circumstances. In line with normal practice it was predicated on an average life expectancy.

70. Mr Laurie had conceded in a letter to HMRC dated 8 August 2016, that: "The quantification of the sum of £18m took no account of Mr Clark's state of health and likely mortality".

71. Mr Bartlet's witness statement evidence was that had the mortality component taken account of Mr Clark's actual health then the Payment would have been £3,225,000 less than it actually was. The Calculation dated June 2016 which he produced stated that figure at £3,225,684. It is unclear from whence the figure of £3,595,000 in the Notice of Appeal is derived; perhaps it is a typographical error.

72. The US parent had an interest, and the US GAAP was relevant, as Mr Laurie conceded in his letter to HMRC dated 3 September 2015, when he argued that:

> "…the US parent sought to remove the contingent liability in respect of his contracted right from the group balance sheet. This was the basis on which the company approached negotiations, as quantified under the US GAAP principles…".

73. Mr Thornhill in his Reply Submissions endeavoured to argue that the US GAAP had "underestimated" Mr and Mrs Clark's rights because the figure used was at the lowest end of a possible range of figures whilst the Company's accounts, prepared under the UK GAAP had used a figure at the upper end. On a similar basis he argued that the computation of the Payment had used an income stream of £1.22 million per annum whereas the Company had used £2.4 million.

74. I have absolutely no evidence as to how or why these figures were arrived at by the US parent and furthermore Mr Bartlet very candidly explained that he had prepared his Calculation based on a "variety of income streams and figures provided". I have no way of knowing how or why one figure or assumption was preferred as against any other.

75. However, I am clear that the Company's parent wished to remove the provision in the Group accounts and therefore its starting point in the computation of the Payment that was eventually agreed was that figure of £15 million. The Payment was freely negotiated and contractually agreed. Both sides were professionally advised.

The Company Letter

76. On 25 February 2014, the Company wrote to HMRC stating explicitly that they had taken advice from solicitors and Tax Counsel.

77. The Company explained that Mr Clark was not in good health and suffered from a neurological condition. In consequence he was not able to continue working and his Service Agreement had been terminated and the Payment made. Had he not been ill it had been intended that he would have continued working for "some time" after his 65th birthday.

78. The Company went on to state explicitly:

> "The Company did not wish the contingent liability to Mr Clark and potentially his spouse to continue open ended and has therefore agreed with Mr Clark to terminate his Service Agreement...The Termination Payment was paid under the Settlement Agreement both to buy out Mr Clark and his wife's entitlements under Clauses 4.3 and 4.4 of his Service Agreement…and to compensate him for loss of employment."

79. The Company explained the reasons why it was considered that the Payment did not fall to be considered:

> (a) As earnings or an emolument of employment under section 62 ITEPA and the reason was that Mr Clark had been fully remunerated for past services and there was no suggestion that it related to future services.
>
> (b) As a payment for the grant of a restrictive covenant because Mr Clark had already granted covenants in the Service Agreement.
>
> (c) As a payment taxable under section 394 on the basis that it was a single payment to a single person.

80. The Company explained that because the Payment was made to Mr Clark on termination of his employment to buy out his and his wife's future rights under his Service Agreement and to compensate him for loss of employment, it was therefore a payment made in connection with the termination of employment under Chapter 3 of Part 6 ITEPA, namely section 401.

81. The Company had not "…sought to determine whether Section 406 ITEPA should apply to an element of the Termination Payment".

Other contact with HMRC

82. Mr Clark's self-assessment tax return for the year ending 5 April 2014 sought a repayment from HMRC of the sum of £7,052,720 under section 406 ITEPA. That was on the basis that:-

> "It is my contention that the payment was made by my employer as compensation for loss of office on account of ill health. I suffer from a debilitating neurological condition and have done so for several years which has prevented me from carrying out my duties. Copy medical papers are attached. I had ceased to attend the office several years before the termination and it became obvious that I would never be able to return …".

83. On 11 March 2014, HMRC wrote to the Company in response to the Company Letter confirming that, on the facts stated, the Payment came within section 401 ITEPA and would benefit from the £30,000 exemption in section 403 ITEPA. HMRC noted that Mr Clark intended to make a section 406 ITEPA claim but pointed out that there was no indication that it would meet the criteria in that section.

84. On 11 March 2015, HMRC issued a Notice of Enquiry to Mr Clark and, on discovering that he had died, a fresh Notice of Enquiry was issued under Section 9A TMA to his Executors on 23 April 2015.

85. On 1 July 2016, HMRC issued the Closure Notice which increased the self-assessment by £7,054,025.85 from an overpayment of £7,052,720.65 to an underpayment of £1,305.20.

86. That Notice was issued on the basis that the relief sought under section 406 on the grounds of disability was not due and that consequently the settlement element of the termination payment, namely, £15,705,613 less the first £30,000, was chargeable to income tax.

87. HMRC offered a review on 19 January 2017 setting out their arguments confirming that the Closure Notice had been issued on the basis that:-

(a) The documentation, and in particular the Settlement Agreement, indicated that the payment was made for reasons other than disability, namely, principally to buy out the pension rights created by the earlier Service Agreement, as amended.

(b) The Settlement Agreement to buy out the pension rights was an arrangement which constituted an EFRBS within section 393A with the lump sum representing "relevant benefits" within section 393B paid on or in anticipation of retirement. That is chargeable as employment income under section 394.

(c) Section 393 automatically disapplies Part 6, Chapter 3 of ITEPA meaning that if income is chargeable under sections 393 and 394 it cannot qualify for relief under section 406.

(d) As the pension rights conferred by the Service Agreement pre-dated Mr Clark's poor health, the lump sum payment and substitution of those rights was not a benefit "in respect of ill-health" meaning that the exclusion in section 393B(3)(a) was not in point.

(e) Alternatively if Part 6, Chapter 3 did apply the requirements within section 406 are unlikely to be met. Specifically section 406 applies where the payment is made on account of injury or disability of the employee and, following *Horner v Hasted*[1] that means that some or all of the payment has to be because of the disability and not for some other reason. The evidence pointed to the buyout of pension rights as the main reason for the payment.

[1] 1995 STC 766

(f) An apportionment of the total figure to allocate an element to disability is inappropriate because it is not reflected in the original documentation. HMRC relied on *E V Booth (Holdings) Ltd v Buckwell*[2].

Discussion

Observations on the witness evidence

88. As I indicate above there was a paucity of relevant evidence. My starting point is that although I know that Mr Clark died, I do not know what the cause of death might have been. I have no information as to whether or not it was linked to his disability. I have extremely little information about his disability and its functional impact beyond knowing that in the autumn of 2013 his mind was "sharp as a tack" and he was able to cope with complex issues although he had significant physical restrictions.

Mrs Clark

89. Even if Mr Thornhill had been successful in arguing that he could amend the Grounds of Appeal a key problem area for him is Mr Clark. He negotiated the terms of the Settlement Agreement and he submitted his tax return. The clear evidence was that he was totally cognitively active. There was no suggestion from him whatsoever that any part of the Payment was due to Mrs Clark. On the contrary he claimed that it was all attributable to him.

90. Clause 4.1 of the Settlement Agreement explicitly stated that the Payment was to Mr Clark. It was undoubtedly prudent of the Company to ensure that Mrs Clark signed the Settlement Agreement since her husband had negotiated a renunciation of her potential rights under the Service Agreement, to which she was not a party. It does not suggest, let alone, prove that any part of the Payment went to her.

91. The Company Letter, written after having taken advice from solicitors and tax counsel, stated that the payment was to him.

92. The fact that the Payment was paid into a bank account in joint names proves nothing. All of Mr Clark's remuneration was paid into a joint account.

93. There was no evidence from or about Mrs Clark. I know absolutely nothing about Mrs Clark beyond her date of birth, that she is alive, historically left all financial matters to Mr Clark and she is wealthy in her own right. I do not know why she signed the Settlement Agreement and there is no evidence on that; only conjecture by Mr Thornhill.

94. There is no evidence that any part of the Payment was to Mrs Clark and I so find.

Messrs Kilshaw and Laurie

95. Although both witnesses were entirely credible, as can be seen their evidence was of very limited assistance.

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[2] 1980 STC 578

Mr Kilshaw

96. In his witness statement and orally Mr Kilshaw said that he thought that Mr Clark would have worked on past age 65, but he conceded that he had never discussed with him how long he would have worked. He agreed with the statement in the Company Letter that it had been envisaged that Mr Clark would not retire at 65 but that he "…would have continued working for the company for some time absent his ill health on the same basis as prior to his illness."

97. He conceded that he had not advised on the Service Agreement, he had no direct knowledge of Mr Clark's role in the Company and nor did he know why Mr Clark had retired as an executive director in 2009. He had not been involved in Mr Clark's resignation as a non-executive director on 1 February 2013. His understanding had been that Mr Clark had only stopped working on 13 December 2013.

98. In summary, his role was as the family solicitor and in that context he had advised Mr Clark on the Settlement Agreement but his advice had been in relation to employment and he certainly had not advised on any taxation implications. He had not had any involvement in the drafting of the Settlement Agreement.

99. He conceded that when advising on the Settlement Agreement he was aware that Clause 12 provided that that was the only agreement between the parties and also that the only mention of disability was in respect of a potential claim in an Employment Tribunal in relation to disability discrimination and similar.

100. The advice that he had given in relation to the Settlement Agreement was in the context that the Company had not wished the contingent liability to Mr Clark, and potentially his spouse, to continue open ended and therefore both Mr Clark and the Company had agreed to terminate the Service Agreement. That is precisely what was stated in the Company Letter.

Mr Laurie

101. I heard evidence from Mr Laurie who confirmed that he had provided taxation advisory services to Mr Clark from 1994 until his death. In particular, from August 2013, he had advised him on the possible termination of his employment with the Company. Although he too suggested that Mr Clark would have wished to continue working past retirement age, he confirmed that he had had no conversations with him about the length of time that he had wished to work.

102. He had not advised Mr Clark on the terms of the Service Agreement and although he had been contacted by the Company about the Settlement Agreement he was not consulted about the terms of the Agreement itself, simply the tax implications.

103. He did confirm the accuracy of the statement in the Company Letter that the payment was for both compensation for loss of employment and a buy out of the rights in the Service Agreement.

104. He had prepared all of Mr Clark's tax returns over many years and confirmed that his recollection was that all of Mr Clark's earnings went into a joint account. He confirmed that Mrs Clark left all financial matters to her husband, although she did attend meetings from time to time.

Mr Bartlet

105. Mr Bartlet is a senior consulting actuary and was commissioned by Mr Laurie in 2016 to calculate how the Payment would have been different had Mr Clark's life expectancy been based on his actual state of health as independently assessed.

106. I set out below the tenor of his evidence, which was entirely credible, and he did precisely what he was asked to do by Mr Laurie. However, as with Messrs Kilshaw and Laurie, I am not persuaded that it is of any material assistance.

107. Mr Bartlet delivered a Calculation of adjusted reserve for John Ian Clark (sic) (deceased) dated June 2016 (the Calculation).

108. The Calculation stated that it relied "materially" on a member specific underwriting report commissioned by Mr Laurie from Morgan Ash who produced a Life Planning Report dated 7 June 2016 ("the Report").

109. I have reservations about the Report for a number of reasons.

110. Firstly, it was based on a present day assumption (rather than 2013) which it was conceded would show a slightly improved mortality albeit that was stated to be "relatively insignificant". What that means is anyone's guess.

111. Secondly, the underwriting assessment was made on the basis of "the medical information provided" which was precisely the same medical evidence that was produced to this Tribunal.

112. My primary concern is that the conclusion in relation to Mr Clark's health was:

> "Overall, in view of the described history and the comment of 'quite rapid onset ataxia' effectively being wheelchair bound by May 2012 and noted progressive dysarthria, the health from an underwriting point of view was considered very poor".

113. The description in that paragraph is derived from a letter of 1 May 2012 from an American doctor who had had a telephone conversation with Mr Clark and reviewed what he described as "the patient's outside records" and they have not been produced.

114. It does not reflect a letter of 14 June 2012 from the Consultant Neurologist in Edinburgh who had arranged for extensive investigations. That Consultant had also sought a further neurological opinion which was to the effect that "He was not convinced that there was ataxia". That was the Consultant to whom I referred in paragraph 42 above and, of course, that letter in May 2013 reported a significant improvement in Mr Clark's health and that Mr Clark was not wheelchair bound.

115. Clearly the author of the Report had seen that letter since there are inaccurate quotations from it in relation to the diagnosis.

116. Firstly, although at the heading of the May letter the Consultant Neurologist had indeed stated that there was a diagnosis of a presumed neurodegenerative disorder, which the author of the Report quoted, the letter itself states: "… and does rather mitigate

against a neurodegenerative disease. I therefore remain perplexed as to what the underlying diagnosis here is…". That is not reflected in the Report.

117. Furthermore the Report states that Mr Clark had multiple system atrophy. Under the heading "Diagnosis" there is a question mark against that and rightly so since the same Consultant Neurologist had doubted that possibility in the letter dated 14 June 2012.

118. I point to the statement on the last page of the Report that:

> "This report is produced on the information provided. If there is any information that is misleading, omitted or false then this will reduce the reliability of this report."

Precisely. The problem is that there is no way of establishing the quantitative impact of the omissions.

119. Mr Bartlet took the Report to estimate that Mr Clark's life expectancy at age 65 would have been 79.4 years and he used that figure for the Calculation. The outcome was that the adjusted US GAAP reserve at March 2012 would have been £11,774,316 as opposed to £15 million.

120. The consequence was that his opinion was to the effect that had Mr Clark's state of health and consequential life expectancy been factored into the calculation of the Payment then the Payment would have been £3,225,684 less than it was.

121. It should be noted that apart from the life expectancy estimate based on the Report the other assumptions were an income stream of £1.22 million per annum and a discount rate of 6% (which is the basis on which the US GAAP figure of £15 million had been calculated) but different to the UK GAAP at £2.3 million and 4.5%.

122. In 2017, Mr Bartlet was commissioned (the "second Commission") by Mr Laurie in 2017 to provide an answer to the following question:-

> "Suppose Mr Clark had not been prevented by ill-health from continuing to work for Walter Scott & Partners Ltd (WSPL) and had continued to work for an assumed number of additional years earning the gross salary of £2.3m a year (the figure for his last year). On that supposition, how much of the payment of £18m would have been attributable to the loss of earnings for the additional years of assumed work".

123. Mr Bartlet's sole remit in relation to the second Commission was to consider, for a number of possible retirement ages, how the Payment could be notionally allocated between payments that might expect to be received before and after those dates.

124. Working on a number of assumptions he performed calculations of the proportion of the Payment which related to periods before and after a range of assumed retirement dates from ages 66 to 75. Unsurprisingly, he stated that "Selecting alternative assumptions…would produce different allocations …This may be material to the objectives to which these calculations are used."

125. He also made the point that he was again relying on the Report. The other assumptions, as instructed by Mr Laurie, were an income stream of £2.3 million and a discount rate of 4.5% but those are the figures used in the UK GAAP whereas the core figure in the £18 million was the £15 million from the US GAAP.

126. He had not been asked to calculate figures for Mrs Clark but he said that potential payments to her were factored into the gross calculation for the proportion of payments after assumed retirement age. He gave as an example that if Mr Clark were to be assumed to retire at 70 then 69% of the payment would relate to post retirement and 23% of that would be attributable to her notional entitlement.

127. As Mr Bartlet correctly stated this was a counterfactual analysis. Perhaps the most pertinent comment in his witness statement is at paragraph 4.(a) where he stated that in preparing the calculation:

> "I have taken the actual figure paid of £18 million. While I have some understanding of how that figure was calculated, at the end of the day, it is a given of the situation."

128. It most certainly is and it is for that reason that I did not find Mr Bartlet's evidence of material assistance.

129. In summary, quite apart from the issues about the Report, I had grave reservations about some of the obvious disjuncts in Mr Barlet's evidence such as the use of an assumption of the income stream used for the UK GAAP in relation to the US GAAP provision of £15 million. I accept that he simply acted on the instructions that gave rise to those disjuncts. The Calculation and the second Commission are based on numerous assumptions and predicated on what did not happen.

Relevance of the Witness Evidence

130. Firstly, what did happen is that Mr Clark had continued to work whilst unwell and was remunerated on the same basis as previously. The medical evidence is not that he had to retire. I do not know what question he asked his Consultant whilst negotiating the Payment but the reply (see paragraph 43 above) was that he could not work "…in the normal way". I also observe that his health was better in 2013 than it had been in 2012. It was also argued for the appellants that he was disappointed that he did not continue working as an Ambassador for the Company.

131. Neither of the two witnesses who knew him was able to articulate with any precision how long he had intended to work or indeed precisely why the Settlement Agreement was negotiated.

132. The fact is that it was negotiated.

133. As Mr Anderson pointed out when referring to *Kent Foods v HMRC*[3] ("Kent"):

[3] [2008] STC (SCD) 307 at 318

> "…a taxpayer is free to structure his commercial arrangements as he sees fit…with hindsight, it can sometimes be seen that a commercial arrangement has been structured in a way which leads to a tax liability which, by the adoption of a different commercial structure, could have been avoided or mitigated….The starting point on the facts is therefore the arrangements…the evidence as to how the negotiations led to the …documents…is therefore not relevant to their proper construction…".

134. What I do have is Mr Bartlet's *ex post facto* reconstruction of how matters could have been handled differently. The point is that they were not and it is not appropriate now to look back on matters through the prism of hindsight.

135. Although in *E.V. Booth (Holdings) Ltd v HMRC*[4] Mr Justice Browne-Wilkinson (as he then was) was dealing with apportionment of a consideration specified in a contract, the principle is the same as that in *Kent* namely*:*

> *"*The taxation consequences of the method adopted would vary in each case. Once the parties have chosen to adopt one method, in my judgment, the taxation consequences must follow and it is not open to then subsequently to argue that for tax purposes the transaction ought to be treated as if a different method had been adopted."

136. Accordingly, quite apart from my other reservations about Mr Bartlet's evidence, whilst it was interesting, I do not consider that it is relevant.

137. Furthermore, pertinently Clause 12 of the Settlement Agreement was an Entire Agreement Clause (see paragraph 57 above). The effect of section 1(3) of The Contract (Scotland) Act 1997 is that that Clause severely limits the extent to which any extrinsic evidence whether written or oral can be considered

138. I must look primarily at the Settlement Agreement, which falls to be construed according to the ordinary principles, and as Lord Fraser of Tulleybelton stated in *Aberdeen Construction Group Limited v IRC*[5] ("ACG") at 898 F-G that is "…not by looking at it specially from the point of view of …a taxpayer with a possible liability for tax".

139. HMRC are correct in saying that those ordinary principles are:

> (a) The Tribunal is concerned to identify the intention of the parties by reference to "what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean": at paragraph 14 per Lord Hoffmann in *Chartbrook Ltd v Persimmon Homes Ltd*[6].
>
> (b) The exercise is carried out by focussing on the meaning of the relevant words in their documentary, factual and commercial context: *Arnold v Briton*[7] at paragraph 15 per Lord Neuberger, who added that the meaning is to be assessed in light of

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[4] 53 TC 425
[5] [1978] AC 885
[6] [2009] AC 1101;
[7] [2005] AC 1619

(i) The natural and ordinary meaning of the clause;
(ii) Any other relevant provisions of the agreement;
(iii) The overall purpose of the clause and the agreement;
(iv) The facts and circumstances known or assumed by the parties at the time that the document was executed;
(v) Commercial common sense;
(vi) But disregarding evidence of subjective intentions.

140. The "elephant in the room" is that, of course, Mr Clark was very physically disabled and all of the parties knew that. The fact is that, apart from Clause 4.4, and I find that simply to be a narration of a disagreement, there is nowhere in the Settlement Agreement, any reference to the Payment or termination of employment being on the basis of disability. That certainly does not suggest that it was the driver for the Settlement Agreement. (The only other reference is to claims for disability discrimination in Clause 3. That is not the same thing.)

141. Further, notwithstanding Mr Laurie's assertion in his witness statement that he saw no improvement in Mr Clark's health, the very limited medical evidence that has been provided points to an improvement in his health in 2013 yet it seems from Mr Laurie's evidence that he was doing less work.

142. Undoubtedly, Mr Clark wished to attribute the payment to disability and that was his subjective intention but that must be disregarded.

143. To paraphrase Lord Wilberforce in *ACG* at 894 D-E the question to be asked is, as a matter of contract, to what did the Payment relate?

144. The suggestion that it was Mr Clark's inability to work is certainly not borne out by the terms of Clause 4.2 and elsewhere in the Settlement Agreement (see paragraphs 47-57 above). That makes it clear in unequivocal language that the purpose was to buy out the rights accrued under Clauses 4.3 and 4.4 of the Service Agreement, to reflect compensation for loss of employment and to compromise all other possible claims as set out in Clause 3.

145. I observe that whilst Clause 3 refers to other possible claims it refers to Clauses 4.3 and 4.4 of the Service Agreement "in particular". What the Settlement Agreement does <u>not</u> do is to even suggest that any part of the Payment is compensation for premature termination of employment on the grounds of ill health.

146. There is a recognition at Clauses 4.4 and 4.5 that whilst the Company, having taken advice, believed that tax should be deducted, Mr Clark intended to claim that he had retired as a result of disability and the Company declined to pay for advice on that claim. That simply records a difference of opinion and Mr Clark's subjective intention.

147. The rights accruing under Clauses 4.2, 4.3 and 4.4 existed long before the onset of disability. Furthermore the recital also makes no reference to ill health.

148. I find that the Settlement Agreement related only to what it stated that it related to, and that is as set out at Clause 4.2 namely it:

> "… is a payment to buy out the rights of the Executive and the Executive's Wife under Clauses 4.3 and 4.4 of the Service Agreement and to reflect compensation for loss of employment and compromising all other claims set out in Clause 3….".

149. I discuss the component parts of the Payment under the heading Apportionment below.

150. Since I have found that no part of the Payment was made in respect of disability the Payment is not excluded by section 393B(3)(a).

151. I have set out the relevant legislative provisions of Part 6 ITEPA in full at Appendix 2.

Was the Settlement Agreement an EFRBS?

152. Certainly, the Company's Statutory Accounts for the year to 31 December 2012 described Clauses 4.3 and 4.4 as an "unfunded retirement benefit agreement" at Note 1 on page 13 and that the liability is recognised in full. That is not conclusive.

153. As I record at paragraph 9 above in his Skeleton Argument, Mr Thornhill accepted that there was a scheme and disputed only whether the Payment was a benefit paid under the scheme. In his Closing Submissions however, he argued that that he accepted in principle that there was a scheme but that the deed comprising it was the Service Agreement. Sadly, in his Reply he said that it was not.

154. For the avoidance of doubt, I find that the Settlement Agreement, read in the context of the Service Agreement, as it must be since it refers to it, is within the definition of a scheme in terms of section 393A(4).

155. As Judge Brooks stated at paragraph 16 in *Forsyth v HMRC*[8] the next question is to consider whether the Payment was a "relevant benefit".

156. HMRC argue that Mr Clark had agreed to retire and in his Reply to the Closing Submissions, Mr Thornhill accepted that. Even had he not, I have no hesitation in finding that the word "retirement" should be given its natural and ordinary meaning. Mr Clark did retire. He was 65. He left his employment.

157. Before I can decide if the Payment was made "on or in anticipation of retirement"[9] and was thus a relevant benefit, I must look at the component parts of the Payment and the extent to which, if any, there can be an apportionment.

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[8] [2014] UKFTT 915 (TC)

[9] Section 393B (1) (a)

Apportionment

158. Although the Settlement Agreement identified three component elements there was no apportionment and no mechanism for apportionment.

159. Mr Thornhill relied on paragraph 64 in *Reid v HMRC*[10] where Judge Chapman stated:

> "…where a payment has different components which are paid for different reasons…it is logical that a payment can be apportioned because the payment is in reality a number of different entitlements paid in one lump sum rather than separately."

160. The three components of the Settlement Agreement are:

(a) The pension rights in terms of Clauses 4.3 and 4.4 of the Service Agreement,

(b) Compensation for loss of employment, and

(c) Compensation for compromising all claims.

161. I have found that although she was a party to the Settlement Agreement, I do not accept that any part of the Payment was made to Mrs Clark. Whatever the arrangements may have been between her, her husband and the Company, there is no evidence whatsoever in regard thereto.

162. I have also found as fact that the Company very prudently sought to have her as a party to the Settlement Agreement to ensure that she could never subsequently make any claim against it.

163. I have found that the Company's American parent had quantified the value of the pension rights at £15 million.

164. I also find that although Mr Clark had not tendered his resignation by mid July 2013, he was no longer being paid his quarterly salary which was "on hold" pending negotiation of the quantum of the Payment, and his retirement had been agreed in principle.

165. He was in fact paid the salary for the last three quarters on completion of the Settlement Agreement.

166. His right to a pension was in exactly the same sum as his income from employment so there was no potential compensation for loss of employment.

167. There is no evidence whatsoever about any other possible claim other than in respect of the pension rights.

[10] [2016]UKFTT 79 (TC)

168. I find that, on the balance of probability, the disputed part of the Payment was entirely a payment in respect of a commutation of the income based pension rights into a lump sum.

169. For precisely the same reasons as the Company prudently required Mrs Clark to be a party, it equally prudently included in the Settlement Agreement an exclusion of all possible alternative rights of action. That would also be the rationale for the Entire Agreement clause.

170. A very large amount of money was at stake and it would have been professionally negligent to have done anything other than to ensure that all other causes of action or dispute were excluded. That is the commercial reality.

171. Accordingly, I find that although the Settlement Agreement had three components, the reality was that the disputed part of the Payment encompassed only one. There is no basis for apportionment.

172. In any event, and if I am wrong, there is absolutely no basis on which there could be an apportionment. In *Reid*, on the facts found, there was a mechanism set out by the parties[11]. There is no such mechanism here. Mr Bartlet's evidence does not assist, not only for the reasons set out above but also because the parties demonstrably did not consider any of the factors and assumptions that he utilised.

Was the Payment a surrender or loss of rights?

173. The appellants argue that the payment was a surrender rather than a commutation of pension rights, that that surrender was at a loss because it was at less than what Mr Thornhill described as "market value" and it therefore could not possibly be a benefit.

174. He asserted that the US GAAP underestimated the value of the pension rights but no evidence whatsoever was led in that regard. He merely pointed to the difference in approach for the UK GAAP and the US GAAP. The onus of proof lies with the appellants.

175. The negotiation of the quantum of the Settlement Agreement appears to have taken at least six months. Mr Clark was an expert in investment. He would be expected to have understood accounts. He had the ability and money to access expert professional assistance. He accepted the quantification by reference to the US GAAP.

176. I agree with HMRC that there is no evidence of any loss to Mr Clark or any reduction in his rights as a result of entering into the Settlement Agreement. Indeed the evidence from Mr Bartlet reinforces the view that the computation of the Payment was generous in that no account was taken whatsoever of his disability and the figures used were rounded up.

[11] Paragraph 80

Decision on EFRBS

177. I find that the Payment was a lump sum and was a commutation of the income based pension which was paid to Mr Clark on his retirement. It is therefore properly taxable as a relevant benefit under an EFRBS.

Was any part of the Payment a termination payment in terms of Section 401 ITEPA?

178. If I am wrong in finding that the Payment is taxable as a relevant benefit under an EFRBS, then I must consider whether it is taxable as a Termination Payment in terms of section 401.

179. Whilst I do not accept that any part of the Payment was such a payment, nevertheless Clause 4.2 of the Settlement Agreement acknowledges that the Payment is subject to Chapter 3 of Part 6 of ITEPA.

180. Section 401 applies to payments received directly or indirectly in consideration or in consequence of the termination of a person's employment. There is no doubt that Mr Clark's employment was terminated and that the entirety of the Payment related thereto.

181. Therefore to the extent, if any, that any part of the Payment is a termination payment then it falls within section 401 and is taxable.

182. That then means that I must consider section 406 which only applies if the payment is "on account" of disability. Undoubtedly Mr Clark was disabled and had been for some time.

183. However, I have already explained at length that the Payment was <u>not</u> on account of disability. Therefore the exception in section 406 cannot apply.

Decision on sections 401 and 406

184. Accordingly if the Payment is a termination payment it is taxable in terms of section 401.

Footnote to Decision

Late Applications

185. Case management decisions, and these applications are precisely that, are an exercise of judicial discretion and therefore Rule 2 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ("the Rules") applies. It reads as follows:

> **"2.—Overriding objective and parties' obligations to co-operate with the Tribunal**
> (1) The overriding objective of these Rules is to enable the Tribunal to deal with cases fairly and justly.
>
> (2) Dealing with a case fairly and justly includes—

(a) dealing with the case in ways which are proportionate to the importance of the case, the complexity of the issues, the anticipated costs and the resources of the parties;
(b) avoiding unnecessary formality and seeking flexibility in the proceedings;
(c) ensuring, so far as practicable, that the parties are able to participate fully in the proceedings;
(d) using any special expertise of the Tribunal effectively; and
(e) avoiding delay, so far as compatible with proper consideration of the issues.

(3) The Tribunal must seek to give effect to the overriding objective when it—
(a) exercises any power under these Rules; or
(b) interprets any rule or practice direction.

(4) Parties must—
(a) help the Tribunal to further the overriding objective; and
(b) co-operate with the Tribunal generally."

Admission of Evidence

186. As I indicate above I had two applications to admit evidence on the first day of the hearing.

187. The bank statements were introduced in an attempt to show that Mrs Clark had received some of the Payment. There was no other evidence to that effect.

188. Understandably Mr Anderson objected on the basis that there was no reference to any line of argument to that effect in the Notice of Appeal or in the correspondence with HMRC which had covered the period February 2014 until the date of the hearing.

189. After debate, they were admitted *de bene esse* with Mr Anderson reserving the right to object on the basis of relevance. On the stated Grounds of Appeal the banking information had no relevance but ultimately they were admitted in evidence in case the decision not to permit amendment of the Grounds of Appeal was wrong. However, as indicated above their evidential value was minimal.

Amendment of Grounds of Appeal

190. The issue as to whether any part of the Payment went to Mrs Clark raised its head on more than one occasion. As I indicate above, I having read the appellants' Skeleton Argument before the hearing asked Mr Thornhill if it was his attention to make an application to amend the Grounds of Appeal and he declined. He declined again when he made the application for the second bank statement to be lodged.

191. In his Closing Submissions Mr Thornhill stated that he now wished to "change tack" and look at the question of Mrs Clark's pension surrender. He stated that he had not thought about Mrs Clark until he considered HMRC's Skeleton Argument.

192. Mr Anderson briefly, and reluctantly, addressed the issue of Mrs Clark in his Closing Submissions. HMRC's preparation for the case had been predicated entirely on the basis that the whole thrust of the arguments throughout had been in relation to Mr Clark and Mr Clark alone. It was his self-assessment and the Closure Notice which followed therefrom which lay at the heart of this appeal.

193. He argued that the only reference to Mrs Clark was in the brief Skeleton Argument lodged by Mr Thornhill three weeks before the hearing. Mr Anderson had only realised the possible argument that Mr Thornhill might attempt to run only after commentary from Gloag & Henderson on *ius quaesitum tertio* had been added to the Authorities Bundle after it had been lodged.

194. Mr Anderson relied on Lord Dunedin in *Carmichael v Carmichael's Executrix*[12] pointing out that no evidence supporting an argument on *ius quaesitum tertio* had been adduced and it would have to be. He pointed out that the evidence and the known facts relating to Mrs Clark were very limited.

195. Sadly, in replying to Mr Anderson's Closing Submissions, Mr Thornhill again introduced the subject of Mrs Clark. Firstly, he alleged that Mr Bartlet had made certain statements about Mrs Clark. What Mr Thornhill asserted was certainly not what I had recorded in my notes. His assertion was not supported by his own notes. He eventually conceded that it was simply his understanding of the position.

196. Mr Thornhill then sought permission to recall Mr Bartlet to give clarification of his evidence in relation to Mrs Clark. Mr Anderson quite properly objected pointing out that, although Mr Bartlet had referred to Mrs Clark, there was no detailed information available about her. He renewed his objection on the same basis as previously, pointing out that to raise such an issue in a reply to Closing Submissions was far too late.

197. Mr Thornhill then sought leave to amend his Grounds of Appeal in order to found the application for leave to seek clarification from Mr Bartlet.

198. I refused on the basis that, in my words, "it was far too little and far too late". Mr Thornhill intimated that he would appeal that case management decision. That is his right, if so instructed. I undertook to furnish reasons in the full decision.

199. I was not referred to any law on the adequacy or otherwise of pleadings but I have in mind Lord Woolf MR in *McPhilemy v Times Newspapers Ltd*[13] at pages 792 and 793 which reads:

> "The need for extensive pleadings including particulars should be reduced by the requirement that witness statements are now exchanged. In the majority of proceedings identification of the documents upon which a party relies, together with copies of that parties witness statements, will make the detail of the nature of the case the other side has to meet obvious. This reduces the need for particulars in order to avoid being taken by surprise. This does not mean that pleadings are now superfluous. Pleadings are still required to mark out the parameters of the case that is being advanced by each party. In particular they are still critical to identify the issues and the extent of the dispute between the parties. What is important is that the pleadings should make clear the general nature of the case of the pleader."

[12] [1920] S.C. (H.L.) 195

[13] [1999] 3 A11 ER 775

200. Judge Mosedale, with whom I agree, referred to this quotation in *Worldpay UK Ltd v HMRC*[14] in support of her proposition at paragraph 10 that:

> "10. Having said that, it is no longer the case that a failure to properly plead something is always fatal to being able to raise the issue: the purpose of pleadings is to give each party fair warning of the other party's case in the hearing, and if that is done (perhaps by what is said later in witness statements) then that may be sufficient. But it is normally going to be far too late to raise something new in a skeleton argument as that is almost certainly too late to give fair warning. A party which wishes to raise a new ground should normally apply to amend its pleadings."

201. I was referred to no authorities on late applications to amend pleadings. Rule 5(3)(c) of the Rules provides that the Tribunal may permit or require a party to amend a document. The use of the word "may" in Rule 5(3) means that it is a matter of judicial discretion whether an amendment should be allowed. The power is a case management power which must be exercised in accordance with the overriding objective in Rule 2 of the Rules. Accordingly, I consider that I must carry out a balancing exercise and decide whether, in all the circumstances, it is fair and just to grant the application.

202. The appellants have been professionally advised throughout. Indeed in their explanation as to why the appeal was notified late, it was stated at box 6 of the Notice of Appeal that "matters needed to be discussed in detail with advisers and tax counsel as well as by the Executors as a group".

203. As long ago as 8 August 2016 Mr Laurie was writing to HMRC stating that the case put forward at that stage was based on Mr Thornhill's opinion.

204. It is therefore very disappointing that it was only at the point that Skeleton Arguments were lodged, some three weeks before the hearing, that there was even any reference whatsoever to Mrs Clark.

205. In this hearing, whether or not an application to amend would have been granted on the first day, Mr Thornhill chose not to make any such application.

206. I agree with Judge Cannan at paragraphs 118 and 119 in *Moreton Alarm Services v HMRC*[15] where he said:

> "118. Mr Baig relied on authorities in the context of late amendments to pleadings in the civil courts. In particular the summary of principles by Carr J in *Quah v Goldman Sachs International [2015] EWHC 759 (Comm)* at [37] and [38]:
>
> > "37…the relevant principles applying to very late applications to amend are well known. I have been referred to a number of authorities : Swain-Mason v Mills & Reeve [2011] 1 WLR 2735 (at paras. 69 to 72, 85 and 106); Worldwide Corporation Ltd v GPT Ltd [CA Transcript No 1835] 2 December 1988; Hague Plant Limited v Hague [2014] EWCA Civ 1609 (at paras. 27 to 33); Dany Lions Ltd v Bristol Cars Ltd [2014] EWHC 928 (QB) (at

[14] [2019] UKFTT 235 (TC)

[15] [2016] UKFTT 192 (TC)

paras. 4 to 7 and 29); Durley House Ltd v Firmdale Hotels plc [2014] EWHC 2608 (Ch) (at paras. 31 and 32); Mitchell v News Group Newspapers [2013] EWCA Civ 1537.

38. Drawing these authorities together, the relevant principles can be stated simply as follows:

a) whether to allow an amendment is a matter for the discretion of the court. In exercising that discretion, the overriding objective is of the greatest importance. Applications always involve the court striking a balance between injustice to the applicant if the amendment is refused, and injustice to the opposing party and other litigants in general, if the amendment is permitted;

b) where a very late application to amend is made the correct approach is not that the amendments ought, in general, to be allowed so that the real dispute between the parties can be adjudicated upon. Rather, a heavy burden lies on a party seeking a very late amendment to show the strength of the new case and why justice to him, his opponent and other court users requires him to be able to pursue it. The risk to a trial date may mean that the lateness of the application to amend will of itself cause the balance to be loaded heavily against the grant of permission;

c) a very late amendment is one made when the trial date has been fixed and where permitting the amendments would cause the trial date to be lost. Parties and the court have a legitimate expectation that trial fixtures will be kept;

d) lateness is not an absolute, but a relative concept. It depends on a review of the nature of the proposed amendment, the quality of the explanation for its timing, and a fair appreciation of the consequences in terms of work wasted and consequential work to be done;

e) gone are the days when it was sufficient for the amending party to argue that no prejudice had been suffered, save as to costs. In the modern era it is more readily recognised that the payment of costs may not be adequate compensation;

f) it is incumbent on a party seeking the indulgence of the court to be allowed to raise a late claim to provide a good explanation for the delay;

g) a much stricter view is taken nowadays of non-compliance with the Civil Procedure Rules and directions of the Court. The achievement of justice means something different now. Parties can no longer expect indulgence if they fail to comply with their procedural obligations because those obligations not only serve the purpose of ensuring that they conduct the litigation proportionately in order to ensure their own costs are kept within proportionate bounds but also the wider public interest of ensuring that other litigants can obtain justice efficiently and proportionately, and that the courts enable them to do so."

119. As to the last point, it is clear that a similar approach applies to compliance with the Rules of this Tribunal – see *BPP Holdings Limited v Revenue & Customs Commissioners*….".

207. Mr Thornhill's only explanation for the delay in even mentioning Mrs Clark was that it only occurred to him when reading HMRC's Skeleton Argument. That cannot be accurate since his Skeleton Argument was lodged seven days before that of HMRC. Perhaps he meant HMRC's Statement of Case but that was dated 4 May 2017 so that is a very long delay indeed.

208. Quite why he did not ask for leave to amend before the Reply to the Closing Submissions is a complete mystery that he has failed to explain.

209. Furthermore the only evidence he proposed leading in that regard was from Mr Bartlet who, as Mr Anderson pointed out, had previously told the Tribunal he had not been asked to provide figures for Mrs Clark. Nothing is known about her health. Mr Bartlet had told the Tribunal that whilst the likelihood of her predeceasing Mr Clark had been factored into the calculations, divorce had not. Any figures attributable to her potential retirement payments would have been included in the column for her husband.

210. As indicated above, Mr Bartlet's sole remit in relation to the second Commission was to consider, for a number of possible retirement ages, how the Payment could be notionally allocated between payments that might expect to be received before and after those dates. What he certainly was not asked to do was to calculate even notionally what payments related to Mrs Clark's compromise of her rights in terms of Clauses 4.3 and 4.4 of the Settlement Agreement.

211. There is indeed a heavy burden on the appellants to show why it is fair and just for the application to be granted.

212. No good reason has been advanced as to why the application was made so late. It is litigation by ambush.

213. In the absence of any explanation as to why Mr Clark himself and the Company believed that the whole payment was attributable to Mr Clark, and all evidence having been heard, if I were to have granted the application HMRC would have been very severely prejudiced. Furthermore for the reasons given the prospects of success, if any, in that context are minimal.

214. 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.

ANNE SCOTT

TRIBUNAL JUDGE
RELEASE DATE: 20 June 2019

Appendix 1

Clauses 4.3 and 4.4 of the Service Agreement

4.3 Following the termination of your employment, howsoever occasioned, you shall in each of the Company's financial years, until the date of your death, receive from the Company an amount that is equal to 4.84 percent of the Fees received by the Company in the previous financial year of the Company, less such income tax and National Insurance contributions that the Company is required by law to deduct. For the avoidance of doubt, payments of the amounts referred to in this clause 4.3 shall in each year be made in twelve equal monthly instalments.

4.4 From the date of your death, until such time as your surviving spouse or civil partner, if any, also dies, your surviving spouse or civil partner, if any, shall in each of the Company's financial years receive from the Company an amount that is equal to 2.42 percent of the Fees received by the Company in the previous financial year of the Company, less such income tax and National Insurance contributions that the Company is required by law to deduct. For the avoidance of doubt, payments of the amounts referred to in this Clause 4.4 shall in each year be made in twelve equal monthly instalments.

393A Employer-financed retirement benefits scheme

(1) In this Chapter "employer-financed retirement benefits scheme" means a scheme for the provision of benefits consisting of or including relevant benefits to or in respect of employees or former employees of an employer.

(2) But neither—

(a) a registered pension scheme, nor

(b) a section 615(3) scheme,

is an employer-financed retirement benefits scheme.

(3) "Section 615(3) scheme" means a superannuation fund to which section 615(3) of ICTA applies.

(4) "Scheme" includes a deed, agreement, series of agreements, or other arrangements.

393B Relevant benefits

(1) In this Chapter "relevant benefits" means any lump sum, gratuity or other benefit (including a non-cash benefit) provided (or to be provided)—

(a) on or in anticipation of the retirement of an employee or former employee,

(b) on the death of an employee or former employee,

(c) after the retirement or death of an employee or former employee in connection with past service,

(d) on or in anticipation of, or in connection with, any change in the nature of service of an employee, or

(e) to any person by virtue of a pension sharing order or provision relating to an employee or former employee.

(2) But—

(a) benefits charged to tax under Part 9 (pension income) (or that would be charged to tax under that Part but for section 573(2A) or (2B), 646D or 646E]5,

(b) benefits chargeable to tax by virtue of Schedule 34 to FA 2004 (which applies certain charges under Part 4 of that Act in relation to non-UK schemes), and

(c) excluded benefits,

are not relevant benefits.

(3) The following are "excluded benefits"—

(a) benefits in respect of ill-health or disablement of an employee during service,

(b) benefits in respect of the death by accident of an employee during service,

(c) benefits under a relevant life policy, and

(d) benefits of any description prescribed by regulations made by [the Commissioners for Her Majesty's Revenue and Customs].

(4) In subsection (3)(c) "relevant life policy" means—

(a) an excepted group life policy as defined in section 480 of ITTOIA 2005,

(b) a policy of life insurance the terms of which provide for the payment of benefits on the death of a single individual and with respect to which

(i) condition A in section 481 of that Act would be met if paragraph (a) in that condition referred to the death, in any circumstances or except in specified circumstances, of that individual (rather than the death in any circumstances of each of the individuals insured under the policy) and if the condition did not include paragraph (b), and

(ii) conditions C and D in that section and conditions A and C in section 482 of that Act are met, or

(c) a policy of life insurance that would be within paragraph (a) or (b) but for the fact that it provides for a benefit which is an excluded benefit under or by virtue of paragraph (a), (b) or (d) of subsection (3).

(4A) Regulations under subsection (3)(d) may include provision having effect in relation to times before they are made.

(5) In subsection (1)(e) "pension sharing order or provision" means any such order or provision as is mentioned in section 28(1) of WRPA 1999 or Article 25(1) of WRP(NI)O 1999.

394 Charge on benefit to which this Chapter applies

(1) If a benefit to which this Chapter applies is received by an individual, the amount of the benefit counts as employment income of the individual for the relevant tax year.

(1A) Subsection (1) does not apply in relation to the benefit if the total amount of the benefits to which this Chapter applies received by the individual in the relevant tax year does not exceed £100.

(2) If a benefit to which this Chapter applies is received by a person who is not an individual, the [person who is (or persons who are) the responsible person in relation to the scheme under which the benefit is provided is chargeable to income tax on the amount of the benefit for the relevant tax year.

(3) In [this section the "relevant tax year!" is the tax year in which the benefit is received.

(4) For the purposes of subsection (2), the rate of tax is [45%] or such other rate as may for the time being be specified by the Treasury by order.

(4A) Subsection (4B) applies if the receipt of a benefit to which this Chapter applies gives rise to other relevant income of the employee, or the former employee, to or in respect of whom the benefit is provided.

(4B) Subsection (1) or (2) (as the case may be) applies to the amount of the benefit only so far as that amount exceeds the other relevant income.

(4C) In subsections (4A) and (4B) "other relevant income" means—

(a) general earnings of the employee or former employee which are chargeable to income tax,

(b) an amount which counts as employment income of the employee or former employee under Chapter 2 of Part 7A, …

(ba) an amount which would count as employment income of the employee or former employee under that Chapter but for the application of section 554Z5 (overlap with earlier relevant step), or

(c) an amount which would be within paragraph (a), (b) or (ba) apart from—

(i) the employee or former employee having been non-UK resident for any tax year, or

(ii) any tax year having been a split year as respects the employee or former employee.

(5) No liability to income tax arises by virtue of any other provision of this Act in respect of a benefit to which this Chapter applies.

(6) Subsection (5) does not affect—

(a) any liability to income tax on general earnings, or

(b) any liability to income tax on an amount which counts as employment income under Chapter 2 of Part 7A.

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,

(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.

403 Charge on payment or other benefit

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

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

(3) For the purposes of this Chapter—

(a) a cash benefit is treated as received—

(i) when it is paid or a payment is made on account of it, or

(ii) when the recipient becomes entitled to require payment of or on account of it, and

(b) a non-cash benefit is treated as received when it is used or enjoyed.

(4) For the purposes of this Chapter the amount of a payment or benefit in respect of an employee or former employee exceeds the £30,000 threshold if and to the extent that, when it is aggregated with other such payments or benefits to which this Chapter applies, it exceeds £30,000 according to the rules in section 404 (how the £30,000 threshold applies).

(5) If it is received after the death of the employee or former employee—

(a) the amount of a payment or benefit to which this Chapter applies counts as the employment income of the personal representatives for the relevant year if or to the extent that it exceeds £30,000 according to the rules in section 404, and

(b) the tax is accordingly to be assessed and charged on them and is a debt due from and payable out of the estate.

(6) In this Chapter references to the taxable person are to the person in relation to whom subsection (1) or (5) provides for an amount to count as employment income.

"**406 Exception for death or disability payments and benefits**

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."