Neutral Citation: [2024] UKFTT 001044 (TC)

Case Number: TC09355

FIRST-TIER TRIBUNAL
TAX CHAMBER

By remote video

Appeal reference: PRIVATE

INCOME TAX – relevant amount of settlement payment received from previous employer which is assessable to income tax – consideration of element paid for discrimination in work – section 62 ITEPA – appeal allowed in part

Heard on: 15 October 2024
Judgment date: 18 November 2024

Before

TRIBUNAL JUDGE AMANDA BROWN KC
ANN CHRISTIAN

Between

L

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Michael Firth KC on direct instruction

For the Respondents: Joshua Carey and Sam Way of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. With the consent of the parties, the form of the hearing was a video hearing using the Tribunal video hearing system. A face-to-face hearing was not held because it was expedient not to do so. The documents to which we were referred were contained in a bundle of 615 pages.

2. On 23 April 2024 I determined the application made by the taxpayer (**Appellant**) for this appeal to be heard in private and for the decision to be anonymised. The reasons for that decision are set out in my judgment dated 17 May 2024 *L v HMRC* [2024] UKFTT 401 (TC).

AGREED BACKGROUND

3. The Appellant's appeal is against a closure notice issued by HM Revenue & Customs (**HMRC**) on 10 May 2021 pursuant to section 28A Taxes Management Act 1970 amending the Appellant's self-assessment for the tax year ended 5 April 2015 and assessing them to £115,900.88 additional income tax (**Closure Notice**).

4. Pursuant to an offer letter dated 27 May 2011 the Appellant was employed by the employer as an executive director on terms which paid them a base salary of £A plus a discretionary year end cash bonus and "under certain circumstances, at the sole discretion of the Committee of the Board of Directors of [the employer]," deferred compensation under a "long-term incentive" plan.

5. The offer letter guaranteed the discretionary cash bonus for the Appellant's first year of employment in the sum of $B but provided that any entitlement to future year bonuses would be determined by reference to a non-exhaustive list of factors including "business and market conditions, your individual performance and conduct, including but not limited to adherence to the Firm's code of conduct, your contribution to the Firm's performance, the performance and profitability of both your business unit and the [firm], the strategic objectives of the [firm], your business unit and your team and the associated value attributed to your role and whether you will be remaining in employment with the [firm]".

6. The terms of the long-term incentive scheme provided for the basis on which equity vested. Pursuant to those terms the involuntary termination of employment resulted in the immediate cancellation of any unvested equity-based awards unless the employer applied "involuntary termination not involving any cancellation event". Such treatment was at the sole discretion of the employer.

7. On 31 December 2011 the Appellant was paid their guaranteed bonus and received £C. On 17 January 2011 they were notified that they had been awarded $D in deferred cash and E stock units to vest in three equal tranches on 2 February 2013, 2014, and 2015.

8. The Appellant was informed that their role was at risk of redundancy by letter handed to them on 14 January 2013. That letter also stated that there was no requirement for the Appellant to attend the office and they should not contact clients of the employer during the statutory consultation period of 90 days.

9. We were told that the Appellant's cash bonus for 2012 was $F. We were not informed whether any long-term incentive was awarded; however, we infer from the date of the "at risk of redundancy" letter, the date on which incentive awards were notified for 2011 and the terms of the incentive scheme that the Appellant was probably not notified of any award for that year.

10. On 15 April 2013 the Appellant was made redundant by their employer. The Appellant appealed the redundancy decision. The employer confirmed the decision on 19 August 2013.

11. A claim filed on 11 July 2013 with the Employment Tribunal alleged discrimination, harassment, unfair dismissal, and inequality of pay. The claims were particularised both by reference to the treatment experienced by the Appellant: a) during the period of their employment, and in particular in the period from early 2012, b) in connection with their selection for redundancy, and c) in the redundancy process.

12. The in-work discrimination claim was particularised by reference to:

(1) an unjustified bifurcation of the role to which they had been appointed,

(2) being side lined,

(3) deprived of access to potentially lucrative opportunities to develop business, and

(4) the unfair allocation of client revenues between the Appellant and peers.

As a consequence of this treatment the claim form asserted a detriment in terms of award of cash bonuses and long-term incentives.

13. The alleged harassment was particularised in terms of demeaning/aggressive behaviour and treatment by their peers and superiors.

14. The claim also particularised details of comparator individuals in similar or identical roles paid more than the Appellant. The evidenced delta was of £G in base pay and, in the reporting year ended 31 December 2012, circa £H in cash bonus.

15. The claim sought remedies as follows:

> "- Compensation for financial loss including loss of performance-related rewards;
>
> - Compensation for injury to feelings
>
> - Appropriate recommendations and declarations;
>
> - Interest"

16. The Appellant received advice on the strength of their claims. By reference to the summary note included in the bundle, the terms of that advice are not the model of clarity. The note records:

> "On the documents [Counsel] has seen … [his] view is that the case is reasonably strong.
>
> …
>
> There are four realistic outcomes with associated awards (in very broad brush terms) as follows:
>
> 1. Unfair dismissal claim succeeds but discrimination claim fails - £I plus small amount for basic award etc)
>
> 2. Discrimination claim succeeds but equal pay claim fails – approx. £J net
>
> 3. All claims succeed – approx. £K net
>
> 4. Only the equal pay claim succeeds, the difference"

17. The employer defended the claims but, by 11 October 2013, had indicated a willingness to compromise the claims. The initial offer made included an indication that if the Appellant entered a settlement agreement the employer "remain[ed] prepared to exercise its discretion to ensure favourable treatment of the unvested deferred compensation that had been awarded to [the Appellant] during [their] employment, in accordance with the various plan rules."

18. By an agreement dated 31 March 2014, the claims were compromised in full and final settlement of all claims past, present and future arising from the Appellant's period of employment on the following terms:

(1) No admission of liability by the employer;

(2) The payment of £L gross;

(3) £M in consideration of the waiver of all future claims; and

(4) "involuntary termination not involving a cancellation event" treatment of unvested long term compensation awards.

19. Pursuant to the agreement the Appellant received a total sum of £N including £O (deferred cash component under the long-term incentive plan), £P (cash under the equity award) and shares valued at £Q (accelerated vesting of equity).

20. The settlement sums were made by the employer net of income tax and national insurance contributions on the basis that all but £30,000 of the total sums paid were subject to tax. Under the terms of the settlement agreement, the Appellant was entitled to make representations to HMRC as to any alternative tax treatment of the payments made pursuant to the agreement.

21. The Appellant rendered their 2014/15 tax return on the basis that £O+P+Q was assessable to tax against which the tax-free sum of £30,000 was offset. The balance was considered to be outside the charge to income tax.

22. On 16 January 2017 HMRC opened an enquiry into the return. On the basis of the information received through the enquiry HMRC ultimately concluded that the Appellant had failed to treat the settlement payment correctly.

23. In a communication dated 17 January 2019 between HMRC and the employer, the employer confirmed that the total sum paid to the Appellant was £N treated as follows (excluding pence):

Settlement payment non-taxable element	£ 30,000
Settlement payment taxable element	£N-(M+O+P+Q) – 30,000
Settlement payment	£ M
Deferred compensation payment	£ O
[Incentive] Cash	£ P
[Incentive] Share vesting value delivered in shares	£ Q

24. On 10 May 2021, HMRC issued the Closure Notice which states:

> "**Our conclusion**
>
> I have amended your tax return to reflect what HMRC considers as the correct tax treatment of the £N-(M+O+P+Q) settlement payment.
>
> - £R attributable to non-financial loss (i.e. injury to feelings) during and on termination of the employment outside s62 and s401 [Income Tax (Earnings and Pensions) Act 2003 (**ITEPA**)] and non-taxable.
> - £I attributed to compensation for termination of employment and settlement of potential claims for unfair/wrongful dismissal, falling within the scope of s401 ITEPA 2003 and benefiting from the £30,000 threshold at s403, and
> - £N – I - R – 30,000 (being the balance of the payment) attributed to the financial losses suffered as a result of the discriminatory actions of the

> employer (i.e. unequal pay) within the scope of s62 and taxable as earnings."

25. On review of their decision HMRC identified that the Appellant had already taken the benefit provided for under section 403 ITEPA when rendering their return; accordingly, the amendment was increased to reflect the additional tax due on that £30,000.

RELEVANT LEGISLATION

ITEPA

26. Part 2, Chapter 2 ITEPA introduces the nature of the charge to tax on employment income. Section 6(1) ITEPA provides that the charge to tax on employment income is a charge to tax on general earnings and specific employment income.

27. Sections 9, 10 and 15 ITEPA impose a charge to tax on net taxable earnings from an employment in the year, under the heading of general earnings.

28. Part 3 of ITEPA relates to earnings and benefits etc. treated as earnings within the definition of employment income. Sections 6 and 7 include, within the charge to tax on employment income, "earnings within Chapter 1 of Part 3". That Chapter consists only of s.62 ITEPA, which defines earnings at subsection (2), as:

> "(a) any salary, wages or fee,
>
> (b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth,
>
> (c) anything else that constitutes an emolument of the employment."

29. Part 6 of ITEPA relates to employment income which is not earnings or share related. Chapter 3 deals with, amongst other things, payments, and benefits on termination of employment. So far as relevant, section 401 ITEPA provides that Chapter 3 applies to:

> "(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) …
>
> (3) This Chapter soes not apply to any payment or benefit chargeable to income apart from this Chapter."

30. Section 403 ITEPA creates the charge to tax on payments/benefits falling within section 401 such that the payment/benefit "counts as employment income of the employee or former employee for the relevant tax year in and to the extent that it exceeds the £30,000 threshold".

Equality Act 2010 (EqA)

31. So far as relevant in this appeal, the EqA provides the statutory framework protecting an employee from discriminatory treatment (directly or indirectly) on the basis of various protected characteristics including sex, age, race, and disability.

32. Under section 39(2) EqA an employer must not discriminate against an employee as to the terms of such employment, access to opportunities for promotion or any other benefit or facility, in dismissal or otherwise subjecting the employee to any other detriment.

33. Section 66 EqA provides that any term of a contract of employment which is unfavourable on the basis of sex are deemed to be modified so as not to be less favourable.

34. Pursuant to section 120 the employment tribunal has jurisdiction in respect of discrimination complaints bought by employees. By virtue of sections 119 and 124 the employment tribunal has the power to grant an unrestricted award of compensation.

PARTIES' SUBMISSIONS

35. The terms of the dispute between the parties varied over time. In this judgment we address only the basis on which the dispute had crystalised as at the hearing before us.

Appellant's submissions

36. The Appellant contends that a sum totalling £N was received from their employer of which there is an acceptance that £O+P+Q is subject to tax as declared on their tax return. As the Appellant has accepted that such sum was taxable, they contend that they have acceded to a sum greater than that apportioned by HMRC (the £I) as having been received in connection with the termination.

37. The Appellant also now accepts that tax was properly due in connection with any sum attributed to the equal pay component of their claim under section 62 ITEPA by virtue of section 66 EqA. As such we understand the Appellant's position to accept that further tax is due on £S (i.e. £I + (G+H)x1.5 – (O+P +Q)).

38. The substance of the Appellant's submission as to the non-taxation of £ (taking account of £R injury to feelings accepted by HMRC as outside the charge to tax) is that it represents a payment properly attributed to the discrimination whilst in work is not a payment "from employment".

39. The Appellant seeks to establish the following principles from the case law:

(1) Whether a payment is "from employment" is essentially a question of whether the payment is a reward for services past, present or future, if the payment is not so referable and "from" something else then it is not taxable under section 62 ITEPA (*Hochstrasser v Mays* 38 TC 673 (***Hochstrasser***), *Shilton v Wilmshurst* [1991] STC 88 at 91).

(2) The measure or basis of calculation of a payment does not determine its nature (*Tucker v Granada Motorway Services Ltd* [1978] STC 393).

(3) Damages can be non-taxable even if calculated by reference to amounts that would have been taxable. It is therefore inappropriate to consider the nature of the payment by reference to the counter factual of everyone behaving lawfully. This is so because the measure of loss when redressing the unlawful behaviour will take account of the tax which would have been paid on the sum had it been paid as income (*British Transport Commission v Gourley* [1956] AC 185 (***Gourley***)).

(4) Damages payable in respect of a legal wrong arise from that legal wrong rather than employment, irrespective of how they are calculated. The legal obligation of the wrongdoer is to compensate for the loss sustained (*Gourley*).

(5) It does not make a difference if the wrongdoer is the employer if the nature of the payment made is redress for a legal wrong rather than for the employee's services (*Gourley*).

(6) A payment to terminate employment is not assessable under section 62 ITEPA as "from employment" albeit that it is then taxable under section 401 (*HMRC v Tottenham Hotspur Limited* [2017] UKUT 453 (TCC).

(7) The damages paid to the Appellant are relevantly and appropriately comparable to damages paid for wrongful dismissal which are accepted as not assessable to income tax as being from employment (*Moorthy v HMRC* [2018] EWCA Civ 847 at [33] (***Moorthy***)).

(8) Where part of a payment can be ascribed solely to the settlement of an in-work discrimination claim, it is contended that there can be no question of that payment being made in part as being from employment and in part for another reason requiring consideration of whether the "from employment" reason is sufficiently substantial to justify a conclusion that the payment was taxable under section 62 ITEPA (*Kuehne + Nagel Drinks Logistics Ltd v HMRC* [2012] EWCA Civ 34) (***K+N***)

(9) Whilst it is to be acknowledged that where a payment is established to have been made in substitution for a payment "from employment" the payment made will usually be treated as taxable, such acknowledgement does not replace the requirement to determine whether the payment made (and under consideration) is properly substituted for a payment made from employment (*Mairs v Haughey* [1993] STC 569 (***Mairs***) and *HMRC v E.On UK PLC* [2023] EWCA Civ 1383).

40. Applying these principles the Appellant contends that the payment of £N-(M+O+P+Q)-£0000 is a payment made for breach of the statutory tort of unlawful discrimination under section 124(6) and 119(2)(a) EqA (see *Hounga v Allen* [2014] UKSC 47 which confirms the basis of the tort). The fact that the claim seeks compensation for "financial loss including loss of performance-related rewards" does not, in the Appellant's submission, mean that the payment of such compensation should be taxed as if it were a performance-related award. On the contrary, and on the facts of this case, the payment has been made because the Appellant was deprived of the opportunity to perform their services and be paid the reward. The payment cannot therefore be for past, present or future services because such services were and will never be rendered.

41. Support in this regard was said to be derived from the following observation of Lord Reid in *Gourley*:

> "In a case where the wrongdoer is the plaintiff's employer it has sometimes been said that he would have had to continue to pay the plaintiff's full wages or salary if there had been no accident or wrongful dismissal, so why should he take advantage his own wrong to diminish his liability? … The real answer is, I think, that before the wrong the employer was paying for the plaintiff's services, whereas now he is paying the plaintiff's loss and he will have to pay someone else to perform the services. And this argument would also go too far if valid, for it would seem to involve the proposition that, if a dismissed employee gets other work, the employer ought not to be able to take advantage of that."

42. The Appellant also refers to the judgment in *Mr A v HMRC* [2015] UKFTT 189 (TC) (***Mr A***) in which the Tribunal determined that a payment made by way of compensation for loss suffered as a consequence of discrimination was accepted to be a sum paid other than "from employment". The Appellant invites us to adopt paragraph [81] where the Tribunal stated:

> "[81] If an Employment Tribunal were to award damages for discrimination (whether calculated by reference to earnings or whether they included injury to feelings) these are recompense for the right not to be discriminated against under statute. They are paid because the employer has breached a statutory obligation not to treat the employee in a detrimental way due to his race. They are treated in like manner to a tort claim. It could be said that where the complaint is of underpayment of remuneration that the damages would not

> have arisen if were not for the fact the claimant was an employee but it is clear that it is not enough. That sort of wide test of causation (a "but for" test) is insufficient (see *Hochstrasser v Mayes*). When we pose the question: "Why did the employee receive the payment?" the answer is not that it was in return for the employee's services but because it has been determined that the employer has acted unlawfully by discriminating against the employee. Where damages are calculated by reference to under-paid earnings, while the discrimination may have manifested itself through the way in which the employee was remunerated, the damages arise not because the employee was under remunerated but because the under payment was discriminatory. An award in these circumstances cannot in our view be described as a reward for services. The award is paid for some reason other than the employment and is not earnings. (The extent to which the non-taxability of the damages is taken account of in determining the amount of the compensation award would of course be a matter for the Employment Tribunal making the award to determine in accordance with the relevant law.)"

43. The Appellant contends that the view expressed in *Mr A* is not undermined by the later judgment of the FTT in *Pettigrew v HMRC* [2018] UKFTT 240 (TC) (***Pettigrew***) as asserted by HMRC (see paragraph 48 below) as the matters noted by the judge in *Pettigrew* do not address the principle question whether a payment settling a claim for in-work discrimination is from employment.

HMRC's submissions

44. As provided for in the Closure Notice and subsequent review decision, despite there being no admission of liability by the employer, HMRC accept that the total sum paid under the Settlement Agreement was not a global undifferentiated sum. They accept, at least, that there was a payment of £I in connection with unfair dismissal/discrimination in the redundancy process, £R for injury to feelings and £100 for the surrender of any further rights to claim. However, they contend that the remainder of the sum (including the £101,203 accepted by the Appellant as subject to income tax) is assessable under section 62 ITEPA.

45. HMRC submit that the essential question to be determined is, as set out in *Hochstrasser*, whether the payment is a reward for past, present or future services of the Appellant under their contract of employment. We understand HMRC to accept that where a payment is not so made the mere fact that the quantum of such payment has been calculated by reference to a plaintiff's loss of earnings will not transform the payment into earnings assessable to tax, even where that payment is made by an employer or former employer.

46. HMRC invite us to determine the proper character of the payments made by analysing the substantive rights on which the Appellant sought to enforce the underlying claim and that a claim that there had been discrimination was the start of the exercise and not the end of it. We were taken forensically to the claim documentation which, HMRC contend, establishes that the Appellant sought to recover sums of employment income to which they were properly entitled had the employer not acted unlawfully and, as such, they were sums ultimately paid for the services actually rendered in the course of employment. This was not a case where the only connection to earnings from employment was the basis on which the quantum of the claim had been determined, as might be the case in a personal injury claim. The fact that a claim had needed to be brought in order to secure the payment of sums to which the Appellant was entitled did not alter the analysis of the source of the sums finally paid.

47. Having established that the contested portion of the payment was from employment it did not matter, as per the judgment in *K+N*, that there might also have been another reason, including discrimination, because, on any analysis, the "from employment" reason was a

sufficiently substantial reason for the payment so as to conclude that it should be taxed under section 62 ITEPA.

48. Countering the Appellant's reliance on Mr A HMRC reference the judgment in *Pettigrew* in which HMRC contend, the Tribunal determined the analysis in Mr A to be wrong.

49. HMRC also challenge the Appellant's reliance on *Gourley*. They contend that *Gourley* is authority only for determining how loss is measured/quantified for the purposes of calculating the appropriate award of damages calculated by reference to lost earnings. It does not, they say, establish any principle of general application as to whether damages of a particular kind are taxable in the claimant's hands.

FINDINGS OF FACT

50. There was substantively no disagreement between the parties on the facts as demonstrated by the documents and as set out in the Appellant's witness statement on which Mr Carey cross examined to gain clarification of some aspects of the statement.

51. On the basis of the evidence before us we make the following findings relevant to the decision we have to take:

(1) By the terms of the closure notice, and consistently with the way in which HMRC's case was put before us, HMRC accept that the Appellant received a total of £388,603 but that sum was not a single indivisible amount.

(2) As a consequence of the Appellant's employer agreeing to treat the Appellant's redundancy as an "involuntary termination not involving a cancellation event" the Appellant was paid the deferred remuneration and long-term incentives to which she had become entitled under her contract of employment. The value of these sums was £O+P+Q.

(3) The Appellant was paid £M to compromise her future claims against the employer.

(4) £R was paid on the Vento scale for injury to feelings.

(5) On the basis of the Appellant's largely unchallenged evidence we are prepared to accept that £(G+H)x1.5 of the payment received was in respect of sums to which the Appellant was legally entitled pursuant to section 66 EqA.

(6) Counsel advising the Appellant on the prospects of success of their claim against the employer attributed, and HMRC accept, £I of the payment as properly attributed to the Appellant's unfair dismissal claim. We infer that such sum included amounts to settle the claim for discrimination in the redundancy process.

(7) The balance of the sums received by the Appellant was paid to settle the claim made in respect of discrimination experienced during the period of employment particularised in the claim by reference the bifurcation of her role, lost opportunity to develop business and unfair allocation of revenues causing financial loss.

ISSUE TO BE DETERMINED

52. Whilst the parties are agreed that the components identified under 51(2) and 51(3) are taxable it was not clear to us that they agreed the basis on which the £O+P+Q (i.e. 51(2)) is to be taxed.

53. They agree that the sum at 51(4) is not subject to tax.

54. They dispute whether, and on what basis, the sums identified in paragraphs 51(5) to 51(7) are taxable. We must determine the taxability of the payments. However, in doing so, it is also convenient to determine the basis on which the sum at 51(2) is taxed.

REVIEW OF CASE LAW

55. We start with a brief review of the case law to which we were referred where the interpretation and application was contested by the parties. We deal with it chronologically.

Gourley

56. Mr Gourley suffered personal injury caused by the British Transport Commission which precluded him from continuing to work in his previous office/employment. Damages were assessed in respect of actual and prospective loss of earnings. The House of Lords had to determine whether the damages should be assessed on a net or gross of tax basis (the quantum in each case having been determined at first instance).

57. Earl Jowitt considered that the quantum of damages was to be determined by reference to the loss caused to the plaintiff by reason of the defendant's wrongdoing. As such a reduction in the measure of damages to reflect the tax that would have been paid by the plaintiff had he continued to be able to work and earned the sums that, in consequence of the wrongdoing, he was not unable to earn. That could not, in Earl Jowitt's view, be considered a benefit to the wrongdoer. What the plaintiff had "really lost" was his net income and that is therefore the extent of the damage for which the wrongdoer should be liable.

58. Lord Goddard notes that the damages themselves were not assessable to income tax. He goes on to analyse the loss suffered by a plaintiff who, by reason of another's wrongdoing, is unable to earn income on which he is then liable as a matter of statute to pay tax. He draws no distinction in the assessment of loss attributable to personal injury and wrongful dismissal.

59. Lord Reid confirms that "a successful plaintiff is entitled to have awarded to him such a sum as will, so far as possible, make good to him the financial loss which he has suffered and will probably suffer as a result of the wrong done to him for which the defendant is responsible." The focus of Lord Reid's analysis is on whether the payment of tax is a matter too remote to be considered when assessing the financial loss suffered and concludes that it is not. The proper assessment of loss which requires to be compensated is the net of tax earnings that the plaintiff might reasonably be expected to have received but for the wrongdoing.

Mairs

60. Mr Haughey was an employee of Harland and Wolff (**HW**). His terms and conditions of employment provided a non-statutory enhanced redundancy scheme. When HW was privatised Mr Haughey, and the other employees were offered new employment with the buy-out company which did not provide the enhanced redundancy scheme. In simplified terms, each employee was offered an ex-gratia payment part of which was paid for the termination of the enhanced redundancy rights. The Inland Revenue (as it then was) assessed Mr Haughey to income tax on that part of the payment on the basis that it was a payment "from employment" because it represented an inducement to become or remain an employee of HW in its newly privatised form.

61. The House of Lords applied *Hochstrasser*. Their lordships determined that a payment made to compensate for the loss of a contingent right to a payment, derived its nature from the payment that it replaced. As such, as payment under an enhanced redundancy scheme represented compensation for the consequences of not being able to earn a living from the former employment from which the employee was being made redundant, it was not an emolument from employment. Put another way it was compensation for not being able to work and not a payment for work (whether past present or future). Accordingly, an ex-gratia payment effectively buying out that contingent right was not an emolument.

62. In reaching that conclusion the "qualities" of a redundancy payment were examined in some detail. The House of Lords notes that: redundancy involves an employee finding

themselves without a job through circumstances over which they have no control; it does not give rise to a right to compensation save pursuant to a statutory scheme which reflects that having been employed for a specified minimum period the employee has a stake in his employment that justifies compensation if the stake is lost and, unlike deferred consideration, is dependent on a contingency that everyone hopes will never accrue. Their Lordships go on to evaluate whether such a payment met what they accept as the wide scope of the term emolument noting that a redundancy payment, by its nature, is compensation for not working or being able to work (at least for the paying employer).

63. Some emphasis was placed on the timing of a redundancy payment as it is paid after employment ceases. However, it was readily acknowledged that timing on its own did not remove a payment from being "from employment". In this regard, redundancy was compared and contrasted with deferred remuneration recognising that the distinction between each class of payment may be narrow but is "none the less real". In the case of a deferred payment once the employment comes to an end the right to payment will inevitably accrue. In the case of a redundancy payment, the sum is only payable in limited circumstances and there will be no entitlement if for example the employee leaves the employment of his own accord.

K+N

64. The taxpayer company agreed to make payments to employees who had been transferred to it when entering a joint venture. The payments were made only following the raising of concerns regarding pension provision and the threat of industrial action. HMRC considered the payments made to be "from employment".

65. The FTT found as a fact, that a substantial cause for the payments was to avoid industrial action and that therefore the payments had been made in reference to the services of the employees and in the nature of a reward, inducement, or incentive to work willingly for the taxpayer. This was despite a further finding that the payments had also been made as compensation for pension loss.

66. The Court of Appeal considered that there had been no error of law on the FTT's part. Taxation as an emolument required there to be a relevant connection or link between the payment to the employees and their employment:

> "[32] When considering the cause of or reason for, an event or an act in a particular case the courts steer clear of involvement in general theories of causation. Instead they apply a mix of general principle, legal policy and good-sense pragmatism to determine whether legal liability in accordance with the conditions set by the relevant rules has been established …
>
> [33] All I need say at this point is that the use of 'from' in the idea expressed in the statutory expression 'earnings from an employment' and 'earnings derived from an employment' in a fiscal context indicates, as matter of plain English usage, that there must, in actual fact, be a relevant connection or a link between the payments to the employees and their employment."

67. The Court was clear that the taxpayer's invitation to determine whether the true cause of payment had been to compensate for a loss of pension entitlement placed the focus of attention in the wrong place. What needed to be, and was determined by, the FTT in that case was whether there was, as a matter of fact, a relevant connection or link between the payment and the employment. Once established, that was the end of the matter and taxation as an emolument followed.

Mr A

68. Mr A worked as a trader for a bank. The bank paid him £600,000 to compromise Mr A's grievance. The terms of the grievance included, over time, claims for breach of contract but

principally focused on a claim that he had not been paid his entitlement to salary and bonuses as a consequence of race discrimination. Mr A claimed that the payment was compensation for discrimination not a payment for a shortfall in salary and bonus.

69. As set out in paragraph 42 above the Tribunal observed at paragraph 81 that an award of damages for discrimination by an Employment Tribunal is recompense for the right not to be discriminated against. Such damages could not arise "but for" the employment, however, and by reference to the *Hochstrasser* articulation of whether a payment is received "from employment" a "but for" connection is not sufficient. The Tribunal concluded that a payment representing damages for discrimination could not properly be considered to have been paid as a reward for services rendered. It is noted that the taxability of the payment is a matter to be considered by the Employment Tribunal when making the award. It was considered (at paragraphs 82 – 83) that the settlement of a claim should, at least in the first instance, be characterised in the same way as if the Employment Tribunal had made the award. And further, that it was relevant, particularly when considering a settlement payment, to be cognisant that a single settlement sum may have been paid for multiple reasons some of which may fall within the scope of section 62 ITEPA as by reward for services.

70. When considering whether in the case of a settled claim it is for the tax tribunal to be satisfied on the evidence that discrimination is proven in order to conclude that the payment actually made is to be treated as such for tax purposes, the Tribunal records (paragraph 93):

> "we do need to be satisfied that the reason the payment was made by the employer was (rightly or wrongly on their part) to settle a discrimination claim and not to pay back money which they thought the appellant was entitled to under his service agreement."

71. When evaluating the evidence before it the Tribunal considered "what the parties [said] about the purpose of the payment, how they acted and their communications with each other" (paragraph 107). On the facts the Tribunal determined:

> "[118] … we think the payment of £600,000 was made in respect of the claim for race discrimination which the appellant had threatened to make. The Bank did not wish to defend such a claim and the payment was made to settle the claim. Parties making payments by way of settlement of actual or threatened legal proceedings may of course do so for a variety of reasons which are unrelated to the merits of the despite, e.g. the financial cost, opportunity cost in terms of the time and stress on others. But it is not necessary to apportion what component of the payments related to the merits of the discrimination claim and what related to any other of the various possible reasons. Such components only arise as a result of a claim in respect of which, if judgment had been given by the relevant tribunal in favour of the appellant, the resulting sum which would have been awarded would not have been taxable."

Pettigrew

72. Mr Pettigrew appealed HMRC's decision that a payment made to him by the Ministry of Justice (**MoJ**) was taxable under section 62 ITEPA. Mr Pettigrew was formally a part time chairman of the Industrial Tribunal and latterly a fee paid judge in the Employment Tribunal. Following the *O'Brien v Ministry of Justice* [2013] UKSC 6 litigation which determined that fee paid judges should have had the same pension entitlement as salaried judges and *Miller & others v Ministry of Justice* (Case No 1700853) (***Miller***) the MoJ sought to settle similar claims for other fee paid judges. The appeal concerned Mr Pettigrew's settlement of his *Miller* claim which had been precisely calculated by reference to the additional fee entitlement arising from his sitting days. He claimed that the sum was damages for discrimination as a part time worker and not arrears of salary.

73. HMRC defended the decision that the payment was taxable under section 62 ITEA and invited the Tribunal to determine "whether the payment arise from "the employer-employee relationship", from "being or becoming and employee" or from something else". Reliant on *K+N* it was submitted that where there were both employment and non-employment reasons for payments the amount would be taxable if the employment reason was a "substantial cause". The substitution principle said to be derived from *Haughey* was also said to apply. The fact that the payment was calculated by reference to duties of employment actually performed was accepted not to be determinative but contended to be a strong indicator that the payment was from employment. The terms of the settlement offer letter were said to clearly envisage that the payment was made in respect of the duties performed and represented payment of the sums Mr Pettigrew had been entitled to receive when those duties were performed albeit not paid at the right time, in consequence of discrimination. HMRC contended that *Mr A* had been wrongly decided.

74. The Tribunal found on the facts that the MoJ had settled Mr Pettigrew's claim so as to meet the obligations on it as confirmed in *Miller* i.e., he had suffered detriment to the extent that he had been under paid for the work carried out as a consequence of discrimination as a part time (fee paid) worker.

75. When evaluating whether the payment fell to be taxed under section 62 ITEPA the Tribunal set out the following principles derived from the case law to which the Tribunal had been referred:

(1) A payment can be an emolument even through there is no contractual entitlement to it (paragraph 75 as per *Laidler v Perry* [1966] AC 16)

(2) A payment of compensation for loss of rights directly connected with an employment will generally be an emolument of that employment (paragraph 76 by reference to *Hamblett v Godfrey* [1987] STC 60)

(3) A payment made to satisfy a contingent right to another payment will generally derive its character from the nature of the payment which it replaces (paragraph 77 derived from *Mairs*)

(4) The character for tax purposes of a receipt of compensation for failure to make a payment due, should be the same as that of the payment if it had been paid (paragraph 78 arising from *London & Thames Haven Oil Wharves Ltd v Attwool* [1967] AC 772)

(5) Where there is more than one reason for the payment then the employment must be a sufficiently substantial reason for the payment to characterise it as an emolument of the employment (paragraph 79, as per *K+N*).

76. Mr Pettigrew relied heavily on *Mr A* to support his position in the appeal. When considering the Mr A judgment the Tribunal determined (at paragraph 95) that it did not assist in determining the appeal. This was said to be on the basis that the decision in *Mr A* (1) was not supported by authority, (2) did not consider *K+N* or *Mairs* and (3) in a textbook on industrial relations and employment law it had been noted that the decision may have been fact sensitive.

DISCUSSION

Payment referred to in paragraph 51(1) - £O+P+Q

77. This payment relates to sums that the Appellant was awarded by way of deferred consideration and under the incentive scheme as recorded in the statement dated 17 January 2012. The payments were due to vest in accordance with the scheme pursuant to which they were awarded and in recognition of the Appellant's services as an employee in the year to 31

December 2011. The normal consequence of redundancy would have been for the deferred entitlement to payment of the award to have lapsed, but it was within the sole discretion of the employer under the "various plan rules" to allow the sums awarded to vest despite a termination event.

78. We consider that it is readily apparent that the Appellant had earned the entitlement to receive the sums of deferred consideration and had a contractual entitlement to receive them. In consequence of the discretion exercised by the employer that contractual right was undisturbed. Despite the payment being made post-employment, and consistently with the analysis in *Mairs* we consider the payments to be deferred payments of emoluments taxable under section 62 ITEPA.

79. We do not consider that the employer's stipulation that the Appellant enter a settlement agreement in order that the normal consequences of termination be avoided is capable of changing the nature of the payment. Again, consistent with *Mairs*, we consider that any contingency arising from a requirement that settlement be reached in order that the discretion be exercised cannot alter the nature of the payment as deferred compensation – the payments were and remained for the Appellant's past service and are therefore "from employment".

80. Even were we wrong such that settlement of the claim was a reason we do not consider that it removes the "from employment" reason and, at most, represents an additional reason for the payment. In those circumstances, and in accordance with *K+N*, we would be required to consider whether the "from employment" reason was sufficiently substantive to require taxation under section 62 ITEPA. For the same reasons as identified in paragraph 77 above we consider that it was, and therefore the whole sum is properly taxed in accordance with section 62 ITEPA.

81. Our conclusion in this regard is also consistent with the concession made by the Appellant in respect of the payment made to remediate the employer's failure to pay the Appellant and the relevant comparators respecting the equality requirements of section 66 EqA.

82. Accordingly, and in respect of that part of the payment the Appellant was wrong to treat it as a payment taxed under section 401 ITEPA and should have included the whole sum and not only that above the £30,000 threshold as taxable.

Payment referred to in paragraph 51(5) - £(G+H)x1.5

83. The Appellant accepts that the sums paid in consequence of section 66 EqA are taxable under section 62 ITEPA as they represent the Appellant's contractual right to have been paid for the services provided by them under their contract of employment, properly and lawfully construed.

84. On the basis that we have concluded that the whole of the amount the Appellant treated as taxable within their self-assessment return, related to payment of deferred compensation we find that the whole of the sum attributed to their equal pay claim should be taxed as earned income under section 62 ITEPA and the Appellant's self-assessment was understated by this £(G+H)x1.5.

Payment referred to in paragraph 51(6) - £I

85. The parties are agreed that this amount was paid in connection with the termination of the Appellant's employment. For the reasons stated above we consider this sum to be in addition to the £O+P+Q deferred consideration and £G+H paid by way of equal pay. This sum is assessable to the extent that it exceeds the £30,000 threshold in accordance with sections 401 and 403 ITEPA. The effect of HMRC's amendment following review reflects this position.

Payment referred to in paragraph 51(7)

86. Our task, as clearly explained in the case law, is to determine the nature of the payment and whether, by its nature there is a payment made for the services rendered by the Appellant in the performance of their duties in whole or in substantive part. If it was it will be taxable under section 62 ITEPA.

87. In our view the conclusion and reasoning in *Gourley* does not assist the Appellant's case though neither does it prejudice it. *Gourley* confirms that where an award of damages is not subject to taxation in the hands of the plaintiff the appropriate measure of loss of earnings (actual and/or prospective) will be the sum calculated net of tax.

88. In the present case however, that does not take us much further. We have carefully considered the section of Lord Reid's judgment quoted in paragraph 41 above. In our view, the quoted section must be read in context. Lord Reid was analysing the question of the remoteness of taxation when quantifying loss. Viewing the position between an employer and employee permitted an alternative perspective when considering the question of a plaintiff employee's loss. In particular, whether the employer should benefit from having to pay a lower sum by way of damages than would have been paid had the employee continued in service and, to use the phrase adopted by Earl Jowitt, thereby whether the wrongdoer employer should benefit from its wrongdoing. We consider that all that can be derived from Lord Reid's comment is that there is no benefit to the employer from the wrongdoing because, having done wrong it will be paying someone else to perform the services that would have been performed by the plaintiff and it is making the plaintiff whole for the loss suffered from wrongdoing by way of a breach of contract or having caused personal injury.

89. As regards *Mairs* we readily accept that it establishes that a payment made to satisfy a contingent right will derive its character from the nature of the payment it replaces. But we also consider that assistance is derived from the analysis of a nature of a redundancy payment. A redundancy payment is not taxable under section 62 ITEPA because it is not a payment "from employment", it is not a reward for past, present or future, services provided by the employee to the employer under their contract for services. As noted in *Mairs* it is a payment made to reflect that the employment has been terminated and no services will therefore continue to be provided. It is therefore contingent on the absence of employment. Of course, redundancy payments are taxed under section 401 ITEPA but that is not relevant to the analysis of why it is not taxable under section 62 ITEPA.

90. We consider that the analysis in *Mairs* informs the correct/current interpretation of *Hamblett* to which we were not specifically taken but which justifies one of the principles identified in *Pettigrew*. *Hamblett* concerned a payment made to Ms Hamblett following a change in her conditions of employment. At the commencement of her employment at GCHQ she had been permitted and encouraged to join a staff association or trade union. Subsequently, following a policy change, membership of such associations was precluded; each affected employee received a payment upon accepting the change of terms of employment provided that they remained with the employer. Refusal to accept the change (or request a redeployment) resulted in dismissal. The relevant charging provision was contained in section 181(1) Income and Corporation Taxes Act 1970 (**ICTA70**) which taxed emoluments from an office or employment. The question for the court was whether the payment was "from employment".

91. The Court notes that *Hochstrasser* confirmed: it is not sufficient to render a payment assessable that an employee would not receive it unless he had been an employee, it is assessable if it has been paid to him in return for acting as or being an employee". The Court considered that the payment to Ms Hamblett related to a loss of rights under employment protection legislation and thereby directly connected to the fact of her employment. A contrast

is drawn between a payment made by an employer for restricting rights unconnected to the employment (i.e. joining a golf club) which could not be said to be from employment.

92. We understand the conclusion of the court in *Hamblett*, certainly interpreted in the light of *Mairs*, to provide that a payment made to compensate the removal of rights derived from the alteration of the terms on which future services will be provided by the employee to the employer will be a payment from employment, in effect it is an inducement to continue working on changed and less attractive terms. We therefore consider that the single summary of the principle derived from *Hamblett* in *Pettigrew* to be overly simplistic. Whilst a contingent payment made in substitution for a payment should follow the character of the underlying payment the critical issue then becomes the nature of the underlying payment.

93. As indicated above the Appellant contends that their case is essentially on all fours with *Mr A* and that we should apply the reasoning adopted in that case. HMRC contend that *Mr A* is wrongly decided and assert this is confirmed in *Pettigrew*, a later case of competent jurisdiction.

94. We note that whilst the Tribunal in *Pettigrew* expressed reservations about the analysis and conclusion in *Mr A* it stopped short of concluding it was wrong simply that it provided no assistance in determining Mr Pettigrew's case. It is our view that, on the facts, and by reference to the analysis of the binding authorities, there is a material but subtle factual difference between the cases which is more than capable of justifying the different conclusions reached on the facts (as recognised in *Harvey on Industrial Relations and Employment Law*).

95. Mr Pettigrew's claim was made in respect of sums by reference to which he was underpaid under the terms of his contract for services properly construed within the terms of the relevant equalities legislation as confirmed in *Miller*. By virtue of section 39(2) and section 66 EqA (or the equivalent legislation over the term of his employment) the terms on which Mr Pettigrew was employed were modified so as not to be less favourable as a consequence of being a part time worker. In our view, Mr Pettigrew's claim reflected the Appellant's claim to breach of unequal pay (addressed in paragraphs 83 - 84 above).

96. By contrast Mr A's claim was not found to be an equal pay claim (by reference to which comparators would need to be established and proven); the payment was to settle a more general complaint that, as a consequence of race discrimination, he had been unfairly treated under the terms of the bonus scheme and when considering salary increases, there being no specific contractual right to be paid salary increases or bonuses all of which are discretionary. Whilst we accept that there is no reference to *Mairs* or *K+N* we do not consider either case would have resulted in a different conclusion. Judge Raghavan had determined that the nature of the payment which might have been awarded by the Employment Tribunal on Mr A's claim would not have been taxable under section 62 ITEPA as it would not have been a reward for the services actually performed. This was despite the basis of quantification of the claim. This conclusion was confirmed after a thorough consideration of the facts as evidenced, predominantly in the documents, concerning the negotiations between the parties and the terms of the settlement itself. On the evidence therefore the Tribunal did not identify any "from employment" reason for the settlement payment (only discrimination and other potential peripheral efficiency reasons/inferences) with the consequence that *K+N* would have had no application in any event. Accordingly, the contingent payment by way of settlement was in substitution of a claim outside the scope of section 62 ITEPA.

97. In our view the correct approach to be adopted when determining whether a payment made to settle a discrimination is taxable is as follows:

(1) Where a global settlement sum has been paid to compromise a number of discrete claims it must be determined whether that single sum can sensibly and realistically be apportioned and attributed to the various components of the claim.

(2) Where the payment can be apportioned and attributed each portion of the payment is to be considered separately.

(3) Any payment or apportioned part payment which is paid "directly or indirectly in consideration for in consequence of, or otherwise in connection with" termination of employment, the payment will be taxed under section 401 ITEPA.

(4) When considering any part of the payment made otherwise than in the circumstances envisaged under section 401 ITEPA and thereby in connection with a period of employment (past, present or future) the critical question is whether the payment is a reward for services of the employee (*Hochstrasser, Mairs*).

(5) Where claims are made under the EqA the critical focus of attention should be whether the payment is made to compensate for actual or potential discrimination or "to pay back money which [the employer] thought the Appellant was entitled under [their] service agreement".

(6) Where there are multiple reasons for the payment or apportioned part payment the existence of a non-"from employment" reason will be unlikely to deprive the nature of the payment as "from employment".

98. We therefore turn to apply that approach to the facts of this case.

99. By its closure notice HMRC have accepted that there was not a single global payment made by the employer even as regards the balance of the payment over and above the deferred cash compensation and incentive scheme as they have accepted £R as attributable to injury to feelings and £I as attributable to termination of employment (and taxable under section 401 ITEPA).

100. We have found as a fact that the balance was paid to settle the Appellant's claim that they suffered discrimination following the appointment of a second executive director to the team facing the same market thereby bifurcating of the Appellant's role, resulting in lost opportunity to develop business and unfair allocation of revenues together causing financial loss. We consider that to be exclusively a reason other than "from employment" because, the heart of this part of the Appellant's claim is not that they were not fairly paid for what work they did but that they were deprived of the opportunity to perform their full role. Consistent with the analysis and description of the nature of a redundancy payment in *Mairs* compensation for such lost opportunity cannot be directly connected to the employment as it was an employment she never fulfilled because of the discrimination she experienced.

101. We are comforted in reaching this conclusion having considered the IDS Employment Law Handbooks, Volume 5 – Discrimination at Work, Chapter 25 – Discrimination during employment, and paragraphs 25.40 – 25.41 concerning promotion. Those paragraphs indicate that the opportunity for promotion as envisaged in section 39(2)(b) EqA covers a wider range of situations than simple promotion or non-promotion including ensuring the experience and guidance necessary to achieve promotion. The text references to an unreported case: *Dinar v Burger King Ltd* ET Case No.15555/95 D. Mr Dinar complained that he was given more menial tasks than his white colleagues. The Tribunal found that the system of allocation of such tasks which were in the absolute discretion of the manager had been abused restricting Mr Dinar's experience in different areas and thereby depriving him of the opportunity to be promoted. Here, the Appellant did not complain directly of being deprived of an opportunity not to be promoted however, and by reference to section 25.64 of the same text (concerning

the prohibition of causing detriment under section 39(2)(d)) it is clear that "detriment" although not defined in statute has consistently been interpreted to mean "anything which the individual concerned might reasonably consider changed their position for the worse or put them at a disadvantage." In our view the Appellant's claim was for damages for the detriment unlawfully caused to their prospects and ability to perform the duties for which they considered they had been employed. They were not rewarded, through this payment, for services they did perform or would ever perform.

102. Consistently with the accepted position of both parties the mere fact that the measure of the damage was the financial loss caused cannot create the necessary causal connection between the payment and any services rendered by the Appellant.

103. In our view whilst the Appellant would not have received the payment had she never been employed by the employer it is plain that a "but for" test is not sufficient. The payment must be a reward for services and for the reasons given it was not.

104. Given that conclusion the exercise demanded in *K+N* does not arise.

105. Accordingly, we conclude that the part of the payment apportioned and attributed to the Appellant's in-employment discrimination claim is not "from employment" and is not assessable under section 62 ITEPA. On the basis that HMRC accept it was not assessable on any other basis it falls outside the scope of income tax.

DISPOSITION

106. For the reasons given we consider that the amendment to the Appellant's self-assessment for the tax year ended 5 April 2015 is overstated. The amount which should have been bought into the Appellant's self-assessment for that year, but was not, is £(G+H)x1.5 + I). The parties are directed to agree the quantum of tax due on the £119,200 which should have been bought into account.

107. The appeal is therefore allowed in part.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

108. 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.

AMANDA BROWN KC
TRIBUNAL JUDGE

Release date: 18th NOVEMBER 2024