Appeal number: FTC/18-20/2010
[2010]UKUT 457 (TCC)

INCOME TAX – Earnings from employment – Whether payment made on TUPE transfer to recognise loss of pension scheme benefits but also to ensure smooth transfer was "from employment" – Whether capital payments could be taxable
NATIONAL INSURANCE CONTRIBUTIONS – Earnings derived from employment

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

KUEHNE & NAGEL DRINKS LOGISTICS LIMITED
MR A STOTT
MR A C JOYCE **Appellants**

- and -

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

TRIBUNAL: MR JUSTICE NEWEY

Sitting in public in London on 11 and 12 November 2010

Jolyon Maugham, instructed by Crowe Clark Whitehill LLP, for the Appellants

Ingrid Simler QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. These appeals are concerned with whether certain payments made to Mr Stott and Mr Joyce are liable to tax and national insurance contributions ("NICs").

2. Mr Stott and Mr Joyce were formerly employees of Scottish & Newcastle UK Limited ("Scottish & Newcastle"), but in 2006 Scottish & Newcastle transferred its drinks distribution business, and, with it, Mr Stott, Mr Joyce and many other employees, to Kuehne & Nagel Drinks Logistics Limited ("KNDL") as part of a joint venture. The payments at issue were made to Mr Stott and Mr Joyce by KNDL, but they were funded by Scottish & Newcastle.

3. The First-tier Tribunal (Judge Charles Hellier) held that the payments were subject to tax and NICs. This was on the basis that the payments were earnings "from" employment within the meaning of section 9 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA") and "derived from" employment for the purposes of section 6 of the Social Security Contributions and Benefits Act 1992.

4. Mr Stott and Mr Joyce both appeal against Judge Hellier's decision, as does KNDL. The proceedings represent a test case. They are intended to determine the tax and NIC position in relation not only to Mr Stott and Mr Joyce, but to other employees who were transferred to KNDL from Scottish & Newcastle.

The facts

5. I can summarise the facts which Judge Hellier found quite shortly.

6. In 2006 Scottish & Newcastle and Kuehne & Nagel agreed on a joint venture arrangement encompassing Scottish & Newcastle's drinks distribution business. A joint venture company was to be established in which Scottish & Newcastle and Kuehne & Nagel were each to have a 50% interest. That company was to enter into a service agreement with KNDL, a subsidiary of Kuehne & Nagel to which the drinks distribution business was to be transferred.

7. Some 2,000 employees were transferred to KNDL pursuant to this scheme. A source of serious concern to employees was that KNDL's pension scheme was less good than Scottish & Newcastle's. Another, more minor issue which arose related to a beer allowance which Scottish & Newcastle employees had enjoyed but which was not to be provided by KNDL.

8. The Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE") applied to the transfer to KNDL. As a result, the contracts of employment of those employees transferred to KNDL would not be terminated but would have effect as if originally made with KNDL. However, regulation 10 of TUPE meant that rights relating to the Scottish & Newcastle pension scheme would not transfer to KNDL. Further, regulation 10(3) barred an employee from bringing any claim against the transferor (here, Scottish & Newcastle) in respect of any lost pension rights.

9. Industrial action was threatened in relation to the pensions position. After several meetings, Scottish & Newcastle offered to make payments totalling £5,000 per employee. It was ultimately agreed that Scottish & Newcastle would pay that sum in two tranches to each member of the Scottish & Newcastle pension scheme who transferred to KNDL. The recipients could choose either to take the money in cash or to have it paid into a pension scheme.

10. £200 of each £5,000 represented compensation for loss of the beer allowance. It is common ground between the parties that the £200 is taxable. The dispute before the First-tier Tribunal and the present appeals relate to the balance of the £5,000 payments.

11. The transfer of the drinks distribution business to KNDL proceeded, and the £5,000 payments were made, as agreed, to employees transferred to KNDL who were members of the Scottish & Newcastle pension scheme. For reasons of convenience, the payments were effected by KNDL, but they were made on Scottish & Newcastle's behalf. KNDL was reimbursed by Scottish & Newcastle.

12. The evidence before Judge Hellier led him to arrive at the following conclusions as to the £5,000 payments (at paragraph 34 of the decision):

> "(i) the genesis of the payment lay in the concern which the employees (through their representatives) had that they would lose the benefit of a defined pension scheme on transfer;
> (ii) the payments were made, both from the employers' and the employees' perspective, as compensation for that change in pension scheme;
> (iii) the payments were made because, had they not been made, it was likely that industrial action would have followed;
> (iv) industrial action would have been damaging to the business of KNDL;
> (v) avoiding industrial action enabled a smooth transition to the new venture and such a transition was sought both by employees and employers."

13. Judge Hellier went on to say this in the next paragraph:

> "To my mind it cannot be said either from the employees' or employers' perspective that the only reason the payments was made was either solely in compensation for the pension changes, or solely in order to achieve a smooth transfer (i.e. avoiding industrial action and having employees working willingly in the new venture). Both these reasons were bound together …. It can no more be said that the employers did not make the payment to compensate the employees than it can be said that the employees did not take the payment for not disrupting the transfer by industrial action. I conclude that the payments were made and received both (i) in order to compensate for loss of pension expectations and (ii) to ensure a 'smooth transfer', and that such was the understanding of all parties."

14. At paragraph 39 of the decision, Judge Hellier said:

> "The only detail of the arrangement which in my view is significant is that the money (apart from the beer money payment) was to be paid only to transferring employees who were members of the [Scottish & Newcastle] scheme."

15. Elsewhere in the decision, Judge Hellier noted that "it was clearly necessary that KNDL would start life with an adequate work force and clearly desirable that they should be motivated and not surly" (paragraph 33) and that "one of the reasons for making the payments was to ensure a smooth transfer with employees who were not disgruntled" (paragraph 36).

16. Judge Hellier analysed the position in the relation to loss of the Scottish & Newcastle pension scheme in the following terms (in paragraphs 50 and 51):

> "Thus an employee who was a member of the scheme was likely to have a right while he remained an employee to accrue for, at a minimum, the period necessary for any consultation relating to a change in the scheme, additional future pension value by reason of his continued employment. The nature of that right was therefore that it would be defeated if the employees left employment, and in particular that it would be immediately extinguished on a TUPE transfer ….
>
> There is a difference between the right I have just described and the expectation that an employee might have of the future accrual of pension value. Such an expectation would not be limited to the minimum additional benefit which an employee could legally enforce; instead it would take into account perceptions by employer and employee of pension as deferred salary, and of the likelihood of any change. … I gathered that, absent the TUPE transfer, the employees

had a lively expectation of future accrual of benefit for a number of years …. The effect of the TUPE transfer was thus to extinguish both any legal right and the expectation which the transferring employees had. The right was not sold or given up or exchanged, but was lawfully extinguished by the TUPE transfer. The expectation was lost."

The legislative framework

17. The taxation of employment income is now dealt with in ITEPA, which has superseded schedule E. Section 9 of ITEPA reads, so far as relevant, as follows:

> "(1) The amount of employment income which is charged to tax under this Part for a particular tax year is as follows.
>
> (2) In the case of general earnings, the amount charged is the net taxable earnings from an employment in the year.
>
> (3) That amount is calculated … by reference to any taxable earnings from the employment in the year ….
>
> …
>
> (6) Accordingly, no amount of employment income is charged to tax under this Part for a particular tax year unless—
> (a) in the case of general earnings, they are taxable earnings from an employment in that year, or
> (b) in the case of specific employment income, it is taxable specific income from an employment for that year"

(emphases added). The meaning of "earnings" is to be found from section 62(2) of ITEPA, which provides that the word means:

> "(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, or
> (c) anything else that constitutes an emolument of the employment."

18. Liability for NICs is addressed in the Social Security Contributions and Benefits Act 1992 ("the 1992 Act"). Section 6(1) of this Act provides for NICs to be paid where "earnings are paid to or for the benefit of an earner over the age of 16 in respect of any one employment of his which is employed earner's employment". The terms "earnings" and "earner" are explained in section 3(1) of the Act. This defines "earnings" to include "any remuneration or profit derived from an employment" (emphasis added) and states that "earner" is to be construed accordingly.

19. The Judge said that he could see no difference between a payment being "from" an employment (under section 9 of ITEPA) and its being "derived from" an employment (under the 1992 Act). He therefore concluded that the test to be applied for NICs was identical to that under section 9 of ITEPA, and there is no appeal on that point. For practical purposes, therefore, the question is whether the payment was "from" the relevant employment, within the meaning of section 9 of ITEPA. If, contrary to the Judge's view, it was not, it will also have fallen outside the NIC legislation.

The First-tier Tribunal decision

20. Judge Hellier held that tax and NICs were payable on the £5,000 payments.

21. Judge Hellier concluded that, where a payment is made for two reasons which are not "dissociable", "[i]f it can be said that such a payment comes from the employment then it is taxable even if the payment can also fairly be said also to come from something else or also be made for a second reason" (paragraph 89). Here (paragraph 104):

> "Because it was paid and received as an incentive to work willingly and without industrial action for the joint venture company, [the payment] was an emolument from the employment. That it was also paid and received as compensation for the loss of the pension scheme does not affect this conclusion. It was paid in reference to the services the employees rendered and was in the nature of a reward or inducement for future willing service."

22. Earlier in the decision, Judge Hellier had expressed the view that the £5,000 payments did not come from the cessation of employment: the cessation of employment was, he said, "the trigger for the payment but they were made because of the loss of pension rights and expectations and to ensure willing work without industrial action" (paragraph 58). Judge Hellier also concluded that "there is no principle that the standpoint of the recipient of the sum is the sole or even the predominant standpoint from which the payment must be viewed" (paragraph 65). Judge Hellier further said this (in paragraph 78):

> "[I]t does not seem to me that authority nowadays compels the conclusion that capital receipts should not be taxable as employment income. I conclude that the nature of a payment as capital or otherwise is irrelevant to its taxability as a fee, a gratuity or a profit under section 62 (or, put another way, that for the purposes of the Act a sum is capital only if it is outwith those things which are made earnings by section 62)."

The parties' cases in summary

The Appellants' case

23. Mr Jolyon Maugham, who appears for the Appellants, argued that the Judge's decision involved three propositions of law: first, that the reason why a payment is made is the same as what the payment is "from"; secondly, that a single "dissociable" payment can be "from" two things at the same time; and, thirdly, that the presence of a taxable reason for a payment is decisive of the fiscal character of the payment irrespective of its weight. Mr Maugham said that the first of these propositions was wrong: the question that the statute requires to be answered, he said, is what the payment is from, not why it was made, and the employee's standpoint is key. Mr Maugham further submitted that the Judge had not provided an answer to the question what the payment was from. With regard to the second proposition, Mr Maugham contended that, as a matter of law, a payment cannot be "from" two things at once. As for the third proposition, Mr Maugham said that if, contrary to his case, a payment could be "from" more than one thing, the "froms" had to be weighed up; it would, he argued, be bizarre if the presence of a taxable "from" was decisive even if it was of little weight when compared with a non-taxable "from".

24. Mr Maugham also submitted that the Judge had been wrong to take the view that there was no need to distinguish between capital and income. A capital payment could not, Mr Maugham said, be taxable.

25. In one respect, Mr Maugham challenged the Judge's factual findings. Mr Maugham explained that he was not disputing the Judge's primary findings of fact but said that these did not support the Judge's later characterisation of them.

HMRC's case

26. Miss Ingrid Simler QC, who appears for HMRC, said that there was no principle to the effect that a payment from two sources, only one of which was employment-related, was not taxable; section 9 of ITEPA could not, Miss Simler submitted, be read as requiring a payment to be only or wholly and exclusively from employment. Miss Simler suggested that, where a payment had two causes, it would be taxable if either employment was the predominant cause or employment was an equal cause. The present case, Miss Simler contended, was one in which, on the Judge's findings (and contrary to her own submissions at first instance), there were two causes, neither of which was predominant. As one of those causes was to do with employment, the payments were, Miss Simler argued, rightly treated as "from" employment. Cases such as *Mairs v Haughey* (1993) 66

TC 273, on which Mr Maugham relied, were distinguishable because the present case was one in which the second reason was as important as the first.

27. Miss Simler submitted that that there was nothing wrong in looking for the reason for a payment and that, in any event, the Judge had not suggested that the standpoint of the recipient was irrelevant or of less importance than the employer's. Miss Simler further argued that, even if there had been an error in the Judge's analysis of the law, it could not be a material one since he had in fact considered matters from the employees' standpoint.

28. With regard to the distinction between capital and income, Miss Simler said that this was not directly relevant. What the statute requires a Tribunal to do, Miss Simler argued, is to determine whether a payment was "earnings" and "from employment". The characteristics which meant that a payment was of a capital nature might also, potentially, indicate that the payment did not constitute "earnings". If, though, a payment did in fact represent "earnings", it was immaterial that it could be categorised as capital.

29. As for the challenge to the Judge's factual findings, Miss Simler said that the Judge's conclusions were supported by his primary findings.

Discussion

The findings of fact

30. It is convenient to address at the outset Mr Maugham's challenge to the Judge's factual findings.

31. Mr Maugham's attack related to passages in the decision in which the Judge concluded that the £5,000 payments were made to secure the future good service of the employees (as well as for the loss of the pension scheme). In paragraph 88 of the decision, for example, the Judge said that the payments were "also made to secure the future good service of the employees", and he referred in paragraph 103 to the payments having been "made and received to secure the continued willing service of the employees". Mr Maugham submitted that such comments were inconsistent with, or at least oversimplified, the Judge's detailed findings of fact. Mr Maugham noted, in particular, that there was evidence that "a high turnover of staff would have benefited the new company" (paragraph 32) and that the Judge had found that "encouraging employees to remain with KNDL in the longer term was not a motive of making the payments" (paragraph 33). Mr Maugham also made the point that the £5,000 payments were made only to members of the Scottish & Newcastle pension scheme even though (he said) there was no suggestion that a strike

would have been limited to pension scheme members; this, Mr Maugham submitted, exposed the real character of the payments as compensation for loss of pension rights.

32. It seems to me, however, that the Judge's findings cannot be faulted. In my judgment, the evidence fully entitled the Judge to conclude that the payments were made, among other things, to secure future good service. There is no inconsistency between that conclusion and the fact that Scottish & Newcastle was not concerned to encourage employees to stay with KNDL on a long-term basis. The Judge explained the position himself in his decision. He said, for instance, that "encouraging employees to remain with KNDL in the longer term was not a motive of making the payments, but it was clearly necessary that KNDL would start life with an adequate work force and clearly desirable that they should be motivated and not surly" (paragraph 33). As for who was to strike, I cannot see that this matters. It was not (and could not be) disputed that the Judge was justified in finding that (to quote from paragraph 34 of the decision) "the payments were made because, had they not been made, it was likely that industrial action would have followed", that that "would have been damaging to the business of KNDL" and that "avoiding industrial action enabled a smooth transition to the new venture". That being so, it is unsurprising that the Judge considered that the payments were made to secure future good service, albeit that (as he also found) they were made too "in compensation for the pension changes" (see paragraph 35).

33. I reject, accordingly, the challenge to the Judge's findings.

The general approach

34. To be taxable under section 9 of ITEPA, a payment must have been received "from" an employment. It is clear from the authorities (and also common ground between the parties) that, in determining whether a payment was "from" an employment, the fact that an employee would not have received a payment but for his employment is not necessarily decisive. This point emerges from *Hochstrasser v Mayes* [1960] AC 376, which concerned a housing scheme which ICI operated for employees who were transferred from one part of the country to another. Employees who had sold houses at a loss were compensated under the scheme. The question was whether the payments were taxable. Lord Radcliffe said (at 391-392):

> "while it is not sufficient to render a payment assessable that an employee would not have received 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. It is just because I do not think that the £350 which are in question here were paid to the respondent for acting as or being an

> employee that I regard them as not being profits from his employment."

At 392, Lord Radcliffe said:

> "The essential point is that what was paid to him was paid to him in respect of his personal situation as a house-owner who had taken advantage of the housing scheme and had obtained a claim to indemnity accordingly. In my opinion, such a payment is no more taxable as a profit from his employment than would be a payment out of a provident or distress fund set up by an employer for the benefit of employees whose personal circumstances might justify assistance."

35. Other members of the House of Lords expressed the point in terms of tests of causation. Viscount Simonds said that the question was "whether the fact of employment is the *causa causans* or only the *sine qua non* of benefit" (see 389), and Lord Cohen said that the Court "must be satisfied that the service agreement was the *causa causans* and not merely the *causa sine qua non* of the receipt of the profit". As Mr Maugham pointed out to me, the distinction between "causa causans" and "causa sine qua non" has since fallen out of favour: in *Brumby v Milner* (1976) 51 TC 583, Lord Simon of Glaisdale spoke (at 613) of "outmoded and ambiguous concepts of causation couched in Latin". It remains the case, though, that (in Lord Radcliffe's words) "it is not sufficient to render a payment assessable that an employee would not have received it unless he had been an employee".

36. On the other hand, a payment need not have been made in return for services to be taxable. This can be seen from *Hamblett v Godfrey* (1986) 59 TC 694, which concerned "ex gratia" payments of £1,000 each which were made to staff at GCHQ in recognition of the withdrawal of the right to belong to a trade union and certain other rights under the Employment Protection Acts. It was held that the payments were taxable. In the Court of Appeal, Neill LJ said that it was "clearly not enough that the payment was received from the employer" but that, on the other hand, "emoluments from employment are not restricted to payments made in return for services". He identified the question as, "was the payment an emolument from the employment? In other words, was the employment the source of the emolument?" He concluded:

> "I have been driven to the conclusion that the source of the payment was the employment. It was paid because of the employment and because of the changes in the conditions of employment and for no other reason. It was referable to the employment and to nothing else. Accordingly, in my judgment, the £1,000 was a taxable emolument."

Balcombe LJ expressed agreement with the judgment of Knox J under appeal. Knox J had decided that the payment at issue "can properly and

should be described as being from the employment", observing that "there is no … independent source other than the Crown's desire to recognise the loss of rights intimately linked with employment".

37. The Courts have stressed that the true question to be answered is that indicated by the statutory words: is the payment in question from the employment? In *Brumby v Milner*, the Court of Appeal, in a judgment subsequently endorsed by a majority of the House of Lords, said (at 608):

> "we would approve the way in which Megarry J. approached the matter in *Pritchard v. Arundale* [1972] Ch. 229, where he said that there were not in truth several questions involving the decision into which of several compartments the receipt was to be fitted, but only one question, that is to say, whether it is shown (though this is not of course a question of onus) that the receipt had the taxable quality of remuneration or reward for services. Cases in the books have tended to treat the question as one in which if there was not merely a payment on personal grounds as a testimonial to personal qualities of the employed recipient, it must be a reward for services, and *vice versa*: but those were cases in which the facts made it necessary that it should be either the one or the other, and they are not inconsistent with the true situation that in every case there is the one question which must be answered in the one sense if the receipt is to be brought within the charge to tax under Schedule E."

Rather more recently, in *PA Holdings Ltd v Revenue and Customs Commissioners* [2010] STC 2343 the Upper Tribunal (Roth J and Judge Hellier) summarised the law as follows (at paragraph 53):

> "The authorities require attention to the statutory words. The only statutory question is … whether the emolument comes from employment. Answering that question is not to be constrained by the mechanistic application of statements found in the case law."

Sources, reasons and standpoints

38. As already mentioned, Mr Maugham criticised the Judge on the basis that he had focused on why the £5,000 payments were made rather than their source and, linked with this, for failing to recognise that the employee's standpoint is key.

39. In this regard, Mr Maugham placed particular reliance on a passage in Viscount Simonds' speech in *Hochstrasser v Mayes*, in which he said (at 390):

> "I accept, as I am bound to do, that the test of taxability is whether from the standpoint of the person who receives it the profit accrues to him by virtue of his office."

40. Mr Maugham pointed out that in *Hamblett v Godfrey* one of the three judges in the Court of Appeal, Neill LJ, remarked (at 726) that this (and certain other) passages from *Hochstrasser v Mayes* were "valuable and authoritative".

41. Mr Maugham further referred to *Shilton v Wilmshurst* [1991] 1 AC 684, which concerned Mr Peter Shilton, the well-known footballer. Nottingham Forest Football Club agreed to pay Mr Shilton £75,000 if he agreed to be transferred to Southampton Football Club; Southampton agreed to pay Nottingham Forest a transfer fee of £325,000. It was held that the £75,000 payment was taxable. Lord Templeman, with whom the other members of the House of Lords agreed, explained the law as follows (at 689):

> "an emolument 'from employment' means an emolument 'from being or becoming an employee.' The authorities are consistent with this analysis and are concerned to distinguish in each case between an emolument which is derived 'from being or becoming an employee' on the one hand, and an emolument which is attributable to something else on the other hand, for example, to a desire on the part of the provider of the emolument to relieve distress or to provide assistance to a home buyer. If an emolument is not paid as a reward for past services or as an inducement to enter into employment and provide future services but is paid for some other reason, then the emolument is not received 'from the employment.'"

A little later, Lord Templeman said (at 689):

> " … Nottingham Forest had a powerful motive for offering an inducement to Mr. Shilton to become an employee of Southampton. This motive does not alter the fact that the £75,000 paid by Nottingham Forest was an emolument 'from employment' because it was an emolument 'from becoming an employee' …."

Mr Maugham argued that Lord Templeman was here looking at matters from the standpoint of the recipient.

42. On the other hand, Lord Templeman spoke of whether an emolument had been paid "as a reward for past services or as an inducement to enter into employment and provide future services but is paid for some other reason". Here, Lord Templeman was plainly considering the employer's reason for making a payment.

43. Other cases also indicate both that the employee's standpoint need not be all-important and that the employer's reasons for making a payment can be relevant. Thus, in *Laidler v Perry* [1960] AC 16, which concerned a company whose practice it was to give each employee a £10 gift voucher at Christmas, Lord Reid said (at 32):

> "I can find nothing in the facts found by the commissioners to contradict their decision. Perhaps the most important is that set out in the passage I quoted earlier giving the *reason* why the directors decided to make these gifts; and that points to their *object* being to obtain beneficial results for the company in future"

(emphases added). A little later, Lord Reid said (at 33):

> "I do not think it necessary to deal with the other authorities cited or referred to in argument. In some it is said that one ought to look at the matter primarily from the point of view of the recipient, and that may well be right where the donor is not the employer. But if one is looking for the causa causans of gifts made by the employer it must surely be right to see why he made the gifts."

Similarly, Lord Hodson said (at 35):

> "It is often said that payments such as these must be looked at from the standpoint of the recipients who treated them as Christmas presents. This is a useful guide in those cases where money is derived not from the employer direct but from some outside source …, but I should have thought that when the payment is made by the employer to the employee it is not irrelevant to look at the intention of the employer who pays the money."

44. In similar vein, Lord Kilbrandon said in *Brumby v Milner* (at 614):

> "the sole *reason* for making the payment to the appellant was that he was an employee, and the payment arose from his employment. It arose from nothing else, as it would have done, if for example, it had been made to an employee for some compassionate *reason*"

(emphases added).

45. Further, I do not think *Hochstrasser v Mayes* should be taken as authority for the proposition that matters must be considered exclusively from the employee's standpoint. Although Viscount Simonds spoke of taxability being determined "from the standpoint of the person who receives [the profit]", he himself referred (at pages 706 and 707) to a matter which suggested that there was "some other reason for the payment", to a consideration which made the appellant "an object of particular concern to

his employers" and to cases "in which the question is whether a payment is made to an employee as a reward for his services or ... is made out of affection or pity"; in each of these passages, Viscount Simonds appears to have been looking to the employer's motivation. In any case, Lords Cohen and Denning delivered speeches of their own which do not contain comments akin to Viscount Simonds', and Lord Keith of Avonholm simply said, "I agree".

46. Neill LJ's judgment in *Hamblett v Godfrey* takes things no further. Although (as mentioned above) Neill LJ referred to Viscount Simonds' comment as "valuable and authoritative", he also said that "one must never lose sight of the fact that these explanations cannot provide a substitute for the statutory words". Further, Neill LJ appears to have recognised that the employer's reasons for making a payment could be material. He noted that one of the "relevant" findings was that the payments in question had been "offered … solely in recognition of the withdrawal of statutory rights", and he concluded that the payments had been made "because of the employment and because of the changes in the conditions of employment and for no other reason".

47. Mr Maugham relied on *Laidler v Perry* as showing the significance to be attached to the employee's standpoint where a payment is made by someone other than employer, and he said that that was the position here (because, by the time the payments were made, the employer was KNDL rather than Scottish & Newcastle). As a result, though, of the joint venture arrangements, Scottish & Newcastle had a continuing interest in the success of the drinks distribution business, as now carried on by KNDL. In those circumstances, it seems to me that Scottish & Newcastle's perspective must be relevant.

48. Mr Maugham accepted that the reasons for a payment could be relevant. He said that they could cast light on what the payment was "from", but he stressed that that was the real question. In my judgment, sources cannot usually be divorced from reasons. Asking what a payment is "from" invites the question, "Why was the payment made?" Answering that question naturally involves an examination of causes and, commonly as a central part of that, reasons. That that is so is borne out by the authorities, in which judges have frequently identified causes and reasons for payments. As Miss Simler pointed out, judges have often used words such as "cause", "reason", "object" and "intention" when deciding whether payments were "from" employment.

49. In the circumstances, I do not think that the Judge can be criticised for focusing on why the £5,000 payments were made. As I see it, the Judge was entitled to take the view that the causes and reasons for the payments were key to determining whether they were "from" employment.

50. More specifically, I do not accept Mr Maugham's submission that the Judge did not provide an answer to the question where the payments were "from". Thus, the Judge stated in terms (in paragraph 104 of the decision):

> "Because [the payment] was paid and received as an incentive to work willingly and without industrial action for the joint venture company, it was an emolument from the employment"

(emphasis added).

51. Further, I agree with the Judge's comment that "there is no principle that the standpoint of the recipient … is the sole or even the predominant standpoint from which the payment must be viewed". In any event, the point does not seem to matter given the Judge's findings. The Judge concluded that it was "the understanding of all parties" (emphasis added) that the payments were made both to compensate for loss of pension expectations and to ensure a smooth transfer. He also said that it could not be said "either from the employees' or employers' perspective that the only reason the payments was made was … in compensation for the pension changes". It thus makes no difference whose standpoint is adopted. The employees and Scottish & Newcastle saw things in the same way.

More than one "from"

52. Mr Maugham argued that the legislation contemplates only one "from". The Tribunal is thus, he said, required to identify a single "from", which Judge Hellier had failed to do. I have not, however, been persuaded.

53. The ultimate question must always be whether a payment is "from" the employment. In deciding that question, the Tribunal may have to consider more than one possible cause of a payment. The Upper Tribunal explained the position as follows in the *PA Holdings* case (at paragraph 53):

> "In some situations, the formulation of an antithesis between one source and another may clarify the process of reaching a decision: for example, finding that a payment is made out of love and affection to a person who happens to be an employee makes it clear that it does not come from employment but from something else; in other situations, the facts may indicate that there is more than one operative cause for the payment and a judgment falls to be made as to whether the employment cause predominates; and in yet other cases, there may be precursor causes for payment, in which event the use of the contrast is not helpful since the conclusion that a payment comes from a particular source will not preclude its coming also from employment."

54. The difficulty which arises in the present case is that, as I read the Judge's decision, he did not regard it as possible either to identify a predominant cause or to characterise a cause as merely a precursor. He concluded that the payments were attributable to two factors which were "not dissociable".

55. In such circumstances, I agree with the Judge that a payment is to be regarded as "from" employment even though it might also be said to be "from" something else. The key question – "Was the payment from employment?" – is fairly answered in the affirmative. Further, the legislation does not exclude the possibility of a payment being "from" something else as well as employment, even if a single "from" can be identified in most cases. Where, as in the present case, a Judge decides that it is impossible to separate or rank causes, there can be no basis for deciding that a payment is to be attributed to a non-taxable one as opposed to a taxable one. The correct conclusion must, I think, be the Judge's: that the payment was from employment regardless of whether it was from something else as well.

56. As mentioned earlier, Mr Maugham suggested that the Judge's approach would mean that the presence of a taxable "from" was decisive even if it was of little weight when compared with a non-taxable "from". However, I do not accept that that is so. On the Judge's findings, this was a case where the taxable "from" was no less important than (and inseparable from) the non-taxable "from". It cannot be inferred that the Judge would have arrived at the same conclusion had the taxable "from" been of less weight than the non-taxable one.

57. It is also to be observed that, given the Judge's findings, it is hard to see what could be achieved by remitting the matter to the First-tier Tribunal. The Judge has already concluded that the causes are "dissociable". There is no reason to suppose that he would feel any more able to identify a single or predominant cause at a re-hearing. To say, as Mr Maugham did, that a payment can be "from" only one thing is to fly in the face of the Judge's findings.

Substitutions

58. Mr Maugham relied on what he termed the "replacement principle". This, he said, meant that if a payment was made in substitution for something else, its character for tax purposes fell to be determined by reference to the something else.

59. The authorities to which Mr Maugham referred on this aspect included *Tilley v Wales* [1943] AC 386. That case concerned a director who was employed by a company at a salary and who was entitled to be paid a pension for 10 years on his employment ceasing. An agreement was

entered into by which the director agreed to accept a reduced salary and to forgo his right to a pension and, in return, the company undertook to pay him £40,000 by two instalments. It was held that the £40,000 was taxable insofar as it related to the salary reduction but not to the extent that it was attributable to the commutation of pension. As regards the latter element, Viscount Simon LC (with whom Lord Atkin and Lord Russell of Killowen concurred) said (at 392):

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

60. Mr Maugham also relied on the decision of Walton J in *Bird v Martland* [1982] STC 603. In *Bird* lump sum payments were made to employees when company cars were withdrawn. Walton J said (at 607):

> "Now if one stands back a little …, and looks at the matter dispassionately, what have we got? We have got a perquisite in the shape of the supply of a subsidised car for the employee, a withdrawal of that perquisite and a sum paid to the employee in lieu of the continuance of that perquisite. On these simple facts I think it difficult to imagine a case where the payment was more within the statutory language of s 183(1) of the Income and Corporation Taxes Act 1970 which says that the expression 'emoluments', which is what is charged under the relevant Schedule, 'shall include all salaries, fees, wages, perquisites and profits whatsoever'."

61. Mr Maugham relied too on *Mairs v Haughey*, a case which he observed had many similarities with the case before me. *Mairs v Haughey* arose out of the privatisation of Harland & Wolff, the Belfast shipbuilders, as part of which the business was to be transferred to a new company. Employees of Harland & Wolff had hitherto been entitled (it would appear, contractually) to the benefit of a non-statutory "enhanced redundancy scheme". Employees who agreed to transfer to the new company had to accept the ending of the enhanced redundancy scheme, but received payments ("element A"), which were described as "ex gratia", equal to 30% of the amounts they would have derived from the enhanced redundancy scheme had they been made redundant. These payments were made by the government department which had hitherto owned Harland & Wolff. Further sums, paid by the new company, were attributed by the Special Commissioner to acceptance by the employees of new terms and conditions of work. The Special Commissioner concluded that it was unrealistic to regard the element A payments as inducements to become employees of the new company, and the House of Lords decided that he had been right to take that view; the element A payments were offered, as the Special Commissioner found, in order to facilitate the elimination of an obstacle to the privatisation. The House of Lords also held that a payment

made under the enhanced redundancy scheme would not have been taxable and, as a consequence, that the element A payments were not taxable either. Lord Woolf, with whom the other members of the House of Lords agreed, said (at 343):

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

Lord Wolff went on to explain (at 347):

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

62. In my judgment, however, these cases are all distinguishable from the present one. Taking *Mairs v Haughey* first, the element A payments were not made as inducements whereas the payments at issue before me were. A second point is that the Harland & Wolff employees were giving up rights whereas the employees with whom I am concerned were principally losing expectations. The point can be illustrated in this way. A non-transferring Harland & Wolff employee would have been entitled to a payment under the enhanced redundancy scheme. In contrast, a Scottish & Newcastle employee who did not transfer to KNDL would have had no right to any payment to compensate him for the pension rights that would have accrued had he continued to be employed by Scottish & Newcastle. Nor, with or without the £5,000 payments, would transferring employees have acquired further rights under the Scottish & Newcastle scheme: as the Judge found, the effect of the TUPE transfer was "to extinguish both any legal right and the expectation which the transferring employees had". A third ground of distinction is that the government department making the element A payments had an interest in the success of the privatisation but not in the new company; in contrast, Scottish & Newcastle had a continuing interest in KNDL's success.

63. As regards *Tilley v Wales* and *Bird v Martland*, the essential point is that the payments now at issue were not made just in substitution for pension rights. The Judge explained the position in the following terms (in paragraphs 87 and 88 of the decision):

> "I can see no basis for distinguishing the reasoning of *Tilley v Wales* if the lump sum in this case could be said to have been paid simply and solely for the loss of the pension rights and not for something else as well …. But in this appeal it seems to me that the payments were not just for the loss of expectation. They were not simply ex gratia payments reflecting the fact that something had been taken away. Instead they were payments also made to secure the future good service of the employees."

64. In the circumstances, I do not consider that the "replacement principle" can be determinative. Saying, as Mr Maugham did in this context, that the "instant Payments were compensation for the loss of pension payments, such compensation having been secured by threatening strike action" fails to do justice to (and is inconsistent with) the Judge's findings of fact. On the Judge's findings, the payments were made both to compensate for loss of pension expectations and to ensure a smooth transfer. The "replacement principle" cannot be invoked to attribute the payments to only one of those elements.

Payment on cessation of employment

65. Mr Maugham took me to *Henley v Murray* (1950) 31 TC 351. This case concerned a payment made to a person on his resignation as a director. Jenkins LJ (at 367) identified in this way the issue which arose:

> " … it is often very difficult to determine the character of a payment made to the holder of an office when his tenure of the office is determined or the terms on which he holds it are altered, and the question in each case is whether, on the facts of the case, the lump sum paid is in the nature of remuneration or profits in respect of the office or is in the nature of a sum paid in consideration of the surrender by the recipient of his rights in respect of the office."

Jenkins LJ went on to say (at 368) that the case before the Court was a "simple case of resignation under which the office was to be immediately vacated and no further services were to be performed", and he decided:

> "the only possible conclusion of law in this particular case seems to me to be that the payment in question was not a payment or remuneration but was a payment made in consideration of the Appellant at the request of the company, giving up his right to continue to be employed by the company down to 31st March, 1944, and to earn and receive his contractual remuneration down to that date."

66. Mr Maugham argued that, in the present case, the £5,000 paid to each relevant employee was "in the nature of a sum paid in consideration of the surrender by the recipient of his rights in respect of the office" (adopting

Jenkins LJ's words). It seems to me, however, that the analogy with *Henley v Murray* is very inexact. The TUPE transfer operated, as the Judge explained, to extinguish "both any legal right and the expectation which the transferring employees had": the employees did not, accordingly, have valuable legal rights. In any event, the question which the statute required the Judge to ask was whether the payments were from employment, not whether they fitted within the particular phrase used by Jenkins LJ. In my judgment, the Judge was fully entitled to take the view he did – that, in the present case, the payments were "made because of the loss of pension rights and expectations and to ensure willing work without industrial action".

Capital and income

67. The authorities on which Mr Maugham principally relied in support of his submission that the Judge had wrongly failed to distinguish between capital and income were *Attorney-General v London County Council* (1900) 4 TC 265, *Tilley v Wales* and *Mairs v Haughey*.

68. As regards *Attorney-General v London County Council*, Mr Maugham referred me to a passage in which Lord Macnaghten said (at 293):

> "Income Tax, if I may be pardoned for saying so, is a tax on income. It is not meant to be a tax on anything else. It is one tax, not a collection of taxes essentially distinct."

However, Mr Maugham accepted that the Courts had not been concerned in the *London County Council* case with the distinction between income and capital. In the circumstances, I do not think Lord Macnaghten's words are of any real help on the issues I have to decide.

69. Turning to *Tilley v Wales*, the facts of this case are summarised in paragraph 59 above. In the course of his speech, Viscount Simon LC, with whom Lords Atkin and Russell of Killowen concurred, said (at 392-393) that he would "take the view that a lump sum paid to commute a pension is in the nature of a capital payment which is substituted for a series of recurrent and periodic sums which partake of the nature of income". On the other hand, Viscount Simon thought that the same view could not, "generally speaking", be taken of an arrangement under which an employee received a single amount in lieu of periodic salary. He said (at 393):

> "I cannot think that such payments can escape the quality of income which is necessary to attract income tax because an arrangement is made to reduce for the future the annual payments while paying a lump sum down to represent the difference."

Later on the same page, Viscount Simon said:

> "I am not myself prepared to go so far as to say … that remuneration for service can never be capital in the sense which would put it outside income tax. It is worth pointing out that the word 'remuneration' does not occur in sch. E at all and it is safer to use the words of the statute. I prefer to limit myself to the case now under consideration, and to say that, whatever part of the [£]40,000 should be regarded as the equivalent of a drop in salary …, is within the charge on profits from the office of director."

70. In the same case, Lord Thankerton agreed that such of the £40,000 as was referable to the reduction in salary was taxable. He said (at 395):

> "It satisfies, in my opinion, the two tests, namely, (i.) whether it arose from the office of director within the meaning of r. 1, and (ii.) whether it is in the nature of income. I may add that I doubt whether the word 'capital' is the exact antonym to the latter test. While I would agree that, according to common experience, any consideration given in return for services in the office of director is likely to be in the nature of income, I am not prepared to state dogmatically that it must in every conceivable case be so, whatever form it takes …. It is enough that there is no difficulty in the present case."

Lord Porter said of the element of the £40,000 relating to the commutation of pension rights (at 397):

> "In my view, a sum received on the sale or surrender of pension rights is not taxable under sch. E because it is neither pension nor annuity and comes under no other heading of that section …. It is not, as I think, a pension or annuity, and, therefore, not income taxable under sch. E, but I doubt if much assistance is to be obtained by making use of the antinomy between capital and income."

71. Overall, it seems to me that a majority, at least, of the House of Lords considered that a payment had to be of an income nature to be taxable: thus, Viscount Simon spoke of "the quality of income which is necessary to attract income tax", and Lord Thankerton identified as a test "whether [the payment] is in the nature of income". However, I do not read the House of Lords as endorsing a conventional income/capital divide: Viscount Simon referred to "capital <u>in the sense which would put it outside income tax</u>" (emphasis added), Lord Thankerton doubted whether "capital" was the "exact antonym" to "in the nature of income", and Lord Porter doubted the usefulness of the "antinomy between capital and income". Moreover, it is plain from the decision that a lump sum payment can be taxable, and both Viscount Simon and Lord Thankerton were doubtful about whether a payment for service could ever escape tax on the

basis that it was capital. There was, further, an emphasis on the importance of the statutory wording: Viscount Simon said that it was "safer to use the words of the statute", and Lord Porter based his conclusion on the fact that the payment did not come under any of the headings in the statute.

72. So far as *Mairs v Haughey* is concerned, Lord Woolf there said (at 348) that for the Inland Revenue to succeed in a certain submission:

> "the Revenue would have to establish, contrary to my provisional view, that the lump sum payment was in the nature of an income payment before it could begin to qualify as being chargeable to tax under Sch E."

However, Lord Woolf was expressing no more than a "provisional view", in very brief terms, on a point that did not affect the outcome of the case. In the circumstances, I do not think *Mairs* takes matters any further.

73. For her part, Miss Simler relied on *Brumby v Milner*, *Hamblett v Godfrey* and *Shilton v Wilmshurst*. As Miss Simler pointed out, *Hamblett v Godfrey* and *Shilton v Wilmshurst* both involved lump sum payments, but in neither case was it suggested that that meant the sums escaped taxation as capital (and that notwithstanding the fact that *Tilley v Wales* was cited in *Hamblett*). In *Brumby v Milner*, Walton J observed at first instance (at 598):

> "In truth, under Schedule E there is no such thing as an emolument in the form of a capital receipt. Had there been, it would have provided the shortest possible of all answers in the leading case of *Hochstrasser v Mayes* …."

74. In my judgment, the right approach is, as Viscount Simon indicated in *Tilley v Wales*, "to use the words of the statute". The relevant statute is now ITEPA, section 62(2) of which defines "earnings". The fact that a payment has characteristics of capital may mean, as Miss Simler recognised, that the payment does not fall within this definition and, hence, that it is not taxable. If, on the other hand, the definition does extend to the payment in question, the payment will, as it seems to me, be taxable regardless of whether it might in other contexts be regarded as capital rather than income. That is probably why lump sums payments such as were at issue in *Hamblett v Godfrey* and *Shilton v Wilmshurst* are taxable. It is presumably also why the £200 payments made in the present case for loss of the beer allowance are accepted to be taxable.

75. In the course of his submissions, Mr Maugham accepted (rightly, in my view) that the £5,000 payments came within the definition of "earnings" given in section 62(2) of ITEPA. It follows, as I see it, that they cannot

escape taxation as being capital. They are to be regarded in this respect in the same way as the £200 beer allowance payments.

Conclusion

76. In all the circumstances, the Judge was, in my judgment, entitled to arrive at the conclusions he did. I shall accordingly dismiss the appeals.

MR JUSTICE NEWEY

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