TC03795

Appeal number: TC/2013/00761

Income tax – taxability of payments made to a "whistle blower" pursuant to order for interim relief under s 129 Employment Rights Act 1996 in connection with a "protected disclosure" for the purposes of s 43A and 103A ERA 96 – whether taxable under s 62 ITEPA 2003 or only taxable to the extent exceeding £30,000 under s 403 ITEPA 2003 – held the payments were not emoluments of the employment, therefore exempt from tax up to £30,000 – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MARIA ELISA TURULLOLS **Appellant**

-and-

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

TRIBUNAL: JUDGE KEVIN POOLE
MS ELIZABETH BRIDGE

Sitting in public at 45 Bedford Square, London on 10 March 2014

The Appellant appeared in person

Aidan Boal, presenting officer of HM Revenue & Customs, for the Respondents

DECISION

Introduction

1. This appeal concerns a narrow (but difficult) legal point on the tax treatment of a particular type of payment made under the Employment Rights Act 1996 ("ERA").

2. In certain situations, an employee who claims to have been unfairly dismissed may apply to an Employment Tribunal for "interim relief" under s 128 ERA. One of those situations is where the employee claims that the principal reason for his dismissal is because he had made a "protected disclosure" within the meaning of s 43A ERA (inserted by the Public Interest Disclosure Act 1998 to provide protection for so-called "whistle blowers").

3. In broad terms, an employee who wishes to make such a claim must apply quickly to an Employment Tribunal after his dismissal and the tribunal is empowered to order "interim relief" if it considers that it is "likely" in due course to find that the principal reason for the dismissal was the making of the protected disclosure.

4. "Interim relief" can be provided in various forms, but the form we are concerned with in this appeal is "an order for the continuation of the employee's contract of employment". Pursuant to such an order, the employer is required to continue paying the employee, and the central question in this appeal was whether such payments should be taxed in full as emoluments, or whether they should be taxed under s 403 Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"), thus exempting the first £30,000 of such payments from income tax.

5. At first sight, this appears to be a simple question. If an employee's contract of employment is "continued", why should the amounts paid pursuant to that continued employment not be taxed in the ordinary way as earnings of the employment? However, the question is not quite as simple as it first appears, because of the detailed statutory basis on which the continuation occurs.

The facts

6. The facts were undisputed in all material respects. We find as follows.

7. The Appellant was employed in 2005 as an internal auditor within an international group of companies. She was based in London and had responsibilities covering Europe and Africa. She had no formal contract of employment or detailed statement of terms and conditions, only an offer letter which set out some basic terms of her employment. One of those terms was a notice period of one month on either side (following satisfactory completion of a three month probationary period). There is no suggestion that her terms of employment included any provision either entitling her to or providing an option for payment in lieu of notice.

8. On 15 October 2009, she was sent an email informing her that her employment was being unilaterally terminated by her employer with effect from the following day.

9. She applied to the Employment Tribunal for interim relief, claiming that the principal reason for her dismissal was that she had made a number of protected disclosures to her employer under s 43A ERA.

10. The Tribunal heard her application on 10 November 2009 and granted interim relief. The terms of the Tribunal's order, dated 18 November 2009, were as follows:

> "THE TRIBUNAL makes an Order for the continuation of the Claimant's contract of employment.
>
> The Claimant's contract of employment with the Respondent shall continue in force (a) for the purposes of pay or any other benefit derived from employment, seniority, pension rights and other similar matters and (b) for the purpose of determining for any purpose the period for which the employee has been continuously employed, from the date of its termination, 16 October 2009, until the determination or settlement of the complaint.
>
> The amount to be paid to the Claimant by way of pay in respect of each normal pay period or part thereof between the date of dismissal and the determination or settlement of the complaint shall be £5,791.67 gross per calendar month, subject to the appropriate legal deductions and shall be paid on the normal pay day for payment. If a normal pay day for payment has occurred after 16 October 2009 to the date of this order, the payment due for that period shall be paid at the next normal pay date together with the pay for that particular period."

11. As will be seen below, the terms of this order mirrored the statutory provisions in ERA pursuant to which it was made. The sum of £5,791.67 referred to in the order was the Appellant's normal gross monthly salary at the time before tax, national insurance or any other deductions.

12. From early December 2009 through until early January 2011, the Appellant continued to receive her monthly pay from her former employers, in accordance with the interim relief order made in November 2009. Her employers simply kept her on their payroll and issued normal monthly pay slips to her, showing the deductions and various other adjustments that were made, all in line with her previous position. They deducted income tax and employee's national insurance contributions under the PAYE system (presumably in accordance with her pre-existing tax code) and accounted for those amounts to HMRC, along with employer's national insurance contributions. They also deducted her employee pension contributions and £50 under the heading "share plan", which was not explored at the hearing but presumably related to her continuing participation in some company share incentive arrangement. They appear also to have continued to pay their employer's pension scheme contributions.

13. At the substantive hearing of the Appellant's case before the Employment Tribunal in October-November 2010, it found she was unfairly and wrongfully dismissed, and whilst she had made one protected disclosure before her dismissal, it was found that neither it nor any of the other protected disclosures she claimed to have made was a ground of any action taken against her by her employer.

14. The Employment Tribunal's decision on the Appellant's substantive claim was issued on 14 January 2011 and sent to the parties on 17 January 2011. At the hearing the question of remedies had been left unresolved and a separate "remedies" hearing had been arranged for 28 January 2011.

15. Very shortly before the remedies hearing (probably only the day before), a settlement agreement was reached between the Appellant and her former employers.

16. The terms of the settlement broadly provided for her legal costs to be paid by her former employers, together with a small payment in respect of outplacement counselling. No other sums were agreed to be paid in respect of the compensation to which the Appellant was entitled in connection with the unfair and wrongful dismissal to which she had been subject. As the Appellant explained it, the advice she received was that any such claim would probably be covered by the payments she had received over the previous year or so pursuant to the interim relief order (as will be seen below, the relevant provisions of the ERA state that payments pursuant to an order in respect of any particular period are to be set against any liability for breach of the employment contract for that period); as the interim relief order would automatically expire on the signing of the settlement agreement, it was not necessary for the settlement agreement to say anything about it, either to terminate it or to record that the payments under it were accepted in satisfaction of her claim to compensation.

17. The Appellant considered that the payments she had received under the interim relief order should be regarded as part of her entitlement to compensation for the termination of her employment, and therefore the first £30,000 of them should be exempt from income tax under the normal "compensation for loss of office" provisions. As tax had been deducted from the payments when made, she submitted a tax return, on 31 January 2011, claiming repayment of the tax which had been deducted by her employers and paid over to HMRC for the tax year 2009-10 (to the extent that tax was attributable to the first £30,000 of the interim relief payments she had received).

18. HMRC enquired into her return and in due course issued a closure notice, amending it to bring the disputed £30,000 back into charge. The effect was to deny the Appellant £11,002 of income tax refund. This decision was ultimately upheld in a formal statutory review and the Appellant appealed to the Tribunal in due course against it.

19. Her notice of appeal to the Tribunal was out of time by a short period, due to a number of factors involving her taking up new employment and moving house. HMRC made no objection to the appeal being entertained in spite of being notified late and we formally gave permission to that effect.

The law

The charging provisions in ITEPA

20. The broad scheme of ITEPA was not in dispute, but it will assist to summarise it briefly.

21. Part 2 of ITEPA imposes income tax on "employment income", which is made up of "general earnings" and "specific employment income" (s 6(1) ITEPA). These two terms are defined in s 7 ITEPA as follows.

22. "General earnings" means:

(1) any earnings within Chapter 1 of Part 3 ITEPA; and

(2) any amount treated as such (under the benefits code and various other provisions which are not relevant for the purposes of this decision),

but excluding, in each case, amounts specifically exempted from income tax.

23. "Specific employment income" means any amount which "counts as employment income" under various stated provisions of ITEPA (including s 403(1) ITEPA – see [27] below), but again excluding any amounts specifically exempted from income tax.

24. S 62 ITEPA (contained in Chapter 1, Part 3 ITEPA) provides, so far as relevant, as follows:

> "**62 Earnings**
>
> (1) This section explains what is meant by "earnings" in the employment income Parts.
>
> (2) In those Parts "earnings", in relation to an employment, 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."

25. The parties are agreed that if the amounts paid to the Appellant pursuant to the order for interim relief fall within this definition, then they are taxable in full as "general earnings" and the appeal must fail.

26. If they do not fall within s 62(2), then the parties are agreed that they would fall within s 401(1) ITEPA (contained within Chapter 3 of Part 6 ITEPA), which provides as follows:

> "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.

27. If they do fall within s 401(1), then s 403(1) (contained in the same Chapter of ITEPA) brings the amounts into charge as "specific employment income" (see [23] above), but only to the extent they exceed £30,000:

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

28. It is clear from s 401(3) ITEPA that if any amount is potentially chargeable both as "specific employment income" under Chapter 3 of Part 6 ITEPA and under any other provision, then the charge under that other provision will take priority – in other words, the £30,000 exemption will not apply if the amounts are in any event taxable as earnings.

29. This appeal therefore turns on the question of whether the interim relief payments to the Appellant fall within the terms of s 62(2) ITEPA set out at [24] above. If they do, then they are taxable in full and the appeal fails. If they do not, then they fall to be taxed under s 403(1) ITEPA (by virtue of which the first £30,000 of such payments are exempted from tax) and accordingly the appeal succeeds.

The ERA provisions relating to the payments

30. It is important to set out in full the provisions under which the payments were made. S 129 ERA provides that the form of order to be made by an Employment Tribunal is "an order for the continuation of the employee's contract of employment". At first sight, the use of this phrase suggests that this appeal is doomed to fail (in the sense that if the employment is continued and the employee continues to be paid her normal salary, why should it not be taxed as earnings?) S 130 however goes on to explain the phrase as follows:

> "**130 Order for continuation of contract of employment**
>
> (1) An order under section 129 for the continuation of a contract of employment is an order that the contract of employment continues in force –

(a) for the purposes of pay or any other benefit derived from the employment, seniority, pension rights and other similar matters, and

(b) for the purposes of determining for any purpose the period for which the employee has been continuously employed,

from the date of its termination (whether before or after the making of the order) until the determination or settlement of the complaint.

(2) Where the tribunal makes such an order it shall specify in the order the amount which is to be paid by the employer to the employee by way of pay in respect of each normal pay period, or part of any such period, falling between the date of dismissal and the determination or settlement of the complaint.

(3) Subject to the following provisions, the amount so specified shall be that which the employee could reasonably have been expected to earn during that period, or part, and shall be paid –

(a) in the case of a payment for any such period falling wholly or partly after the making of the order, on the normal pay day for that period, and

(b) in the case of a payment for any past period, within such time as may be specified in the order.

(4) If an amount is payable in respect only of a part of a normal pay period, the amount shall be calculated by reference to the whole period and reduced proportionately.

(5) Any payment made to an employee by an employer under his contract of employment, or by way of damages for breach of that contract, in respect of a normal pay period, or part of any such period, goes towards discharging the employer's liability in respect of that period under subsection (2); and, conversely, any payment under that subsection in respect of a period goes towards discharging any liability of the employer under, or in respect of breach of, the contract of employment in respect of that period.

(6) If an employee, on or after being dismissed by his employer, receives a lump sum which, or part of which, is in lieu of wages but is not referable to any normal pay period, the tribunal shall take the payment into account in determining the amount of pay to be payable in pursuance of any such order.

(7) For the purposes of this section, the amount which an employee could reasonably have been expected to earn, his normal pay period and the normal pay day for each such period shall be determined as if he had not been dismissed."

31. In other words, the effect of an order under s 129 ERA is to continue the contract of employment only for certain specific purposes, as set out in sub-s 130(1). It does not purport to reinstate the employment itself.

Submissions of the parties

Appellant's submissions

32. The basis of the Appellant's argument was that her employment had undoubtedly been terminated by her employer with effect from 16 October 2009, subject only to the continuation of her right to be paid as if it had not, pursuant to the interim relief order made under s 129 ERA. As was made clear by the Employment Appeal Tribunal in *Dowling v M E Ilic Haulage* [2004] UKEAT 0836 03 0203, the effect of an interim relief order is only to extend the pre-existing contract of employment for the purposes specified in s 130; it does not do so for all purposes (and in particular it is clear that the former employee does not have to provide any services in exchange for the continuing payments made to him/her under the order).

33. Thus the common law position (i.e. that her employment had been terminated with effect from 16 October 2009) remained unaffected. The payments made to her pursuant to the interim relief order were effectively compensation payments for such termination; as such, they could not be regarded as "earnings" within s 62 ITEPA.

34. In support of this proposition, she cited *Mimtec v IRC* [2001] STC (SCD) 101. In that case, the Special Commissioner (Stephen Oliver QC) was considering the taxation of payments made to employees in satisfaction of their entitlement to "protective awards" under the employment protection legislation for failure to follow the statutory consultation process in connection with proposed redundancies. The Appellant submitted that, similar to the payments made in substitution for protective awards in *Mimtec*, the payments she received under the interim relief order had as their source her statutory rights under ERA and not her employment; in no sense could the payments be said to be "paid in return for acting as or being an employee". Any attempt to draw a parallel between her position and that of an employee on garden leave or on paid holiday (both of whom could be said to receive taxable earnings even though they were rendering no services) were misconceived because, as a result of her dismissal, she was no longer an employee when the payments were made.

35. She also submitted that if her Employment Tribunal case had not been settled by agreement, the remedies hearing would have resulted in an award of compensation which would have taken into account the payments she had received under the interim relief order (see sub-s 130(5) ERA) and which would itself have benefited from the normal £30,000 exemption for termination payments. She should not, she submitted, be disadvantaged from a tax point of view simply because she had settled the case rather than obtaining an order of the Employment Tribunal.

Respondents' submissions

36. Mr Boal for HMRC (correctly, in our view) did not seek to argue that the amounts paid pursuant to the interim relief order were salary, wages, fees, profits, gratuities or benefits in relation to the Appellant's employment. His submission was that the sums received by the Appellant pursuant to the interim order were "emoluments" of her employment falling within sub-s 62(2)(c) ITEPA.

37. The basis of his argument was that the "statutory fiction" of continuation of employment for the specific purposes mentioned in sub-s 130(1) ERA effectively provided a sufficient link between the payments and the employment to render the payments "emoluments" of the employment.

38. He pointed out that at the time the interim relief order was made, it was not decided whether the Appellant was entitled to compensation for wrongful or unfair dismissal; against that background, how could it be said that the payments to her represented such compensation? If all her claims had subsequently been dismissed, she would never be entitled to such compensation. He likened her position to that of an employee who had been suspended on full pay during a disciplinary investigation, or who was taking paid holiday: neither would be required to render any services to the employer, but the payments they both received would still be taxable as earnings.

39. He also submitted that the "replacement principle" applied, such that the payments should derive their tax status from the payments of actual salary which they were intended to replace. Here, he referred to *EMI Group Electronics Limited v Coldicott* [1999] BTC 294.

40. Mr Boal pointed to what he considered to be a clear distinction between the situation in this case and that in *Mimtec*. In *Mimtec*, the payments were intended to satisfy entitlements which derived entirely from statute (and not from the contract of employment); in the present case, the payments were made pursuant to a contract of employment, albeit one which had been extended solely for specific purposes (including entitlement to salary, etc) by a statutory fiction.

Discussion and decision

The cases

41. The question of whether a particular payment received by an employee (or a former or prospective employee) is an "emolument of" the employment (or, in the cases relating to the previous version of the law before ITEPA, an "emolument <u>from</u>" the employment) is one that has exercised the courts on a great many occasions.

42. We do not consider that the change in the statutory formulation (the change of "emolument from the employment" to "emolument of the employment") in ITEPA has any effect on the continuing validity of the earlier case law.

43. The classic difficulty encountered in the courts over the years has not been whether a particular payment (or other benefit) should be regarded as a profit, gain or

emolument; it has been whether that profit, gain or emolument was "from" (or, in the current language of ITEPA, "of") the taxpayer's employment.

44. A sound starting point for an examination of the modern authorities on this question is the House of Lords decision in *Hochstrasser v Mayes* [1960] AC 376. That case was concerned with the taxability of a payment made by an employer to its employee in pursuance of a "housing scheme"; this was essentially an indemnity given to particular categories of employees to compensate them for any loss which they might suffer on selling their houses as a result of being required by the company to relocate. The question was whether a payment pursuant to this indemnity was a "profit from the employment" of the employee to whom it was paid.

45. Their Lordships held that it was not. Their reasons for saying so were variously expressed. Lord Denning considered that the payment was not a profit at all, being simply an indemnity against a loss. Viscount Simonds based his decision on the fact that the payment was not "a reward for services". Lord Radcliffe considered that the payment was not made "for acting as or being an employee" but "in respect of his personal situation as a house-owner who had taken advantage of the housing scheme." Lord Cohen (with whom Lord Keith agreed), observed that the taxpayer was "receiving under his service agreement the full salary appropriate to the appointment he held", therefore finding that the housing scheme (rather than the employment) was "the source of the payment sought to be taxed", thus it could not be taxable as a profit from the employment.

46. Viscount Simonds (at p.388) approved the following passage from the judgement of Upjohn J at first instance which, he said, "appears to me to sum up the law in a manner which cannot be improved upon" (possibly apart from, he said, the reference to "past" services near the end):

> "In my judgment, the authorities show this, that it is a question to be answered in the light of the particular facts of every case whether or not a particular payment is or is not a profit arising from the employment. Disregarding entirely contracts for full consideration in money or money's worth and personal presents, in my judgment not every payment made to an employee is necessarily made to him as a profit arising from his employment. **Indeed, in my judgment, the authorities show that to be a profit arising from the employment the payment must be made in reference to the services the employee renders by virtue of his office, and it must be something in the nature of a reward for services past, present or future.**" *[emphasis added]*

47. Lord Radcliffe expressed a similar view, though in slightly different words (at p.392):

> "The test to be applied is the same for all. It is contained in the statutory requirement that the payment, if it is to be the subject of assessment, must arise "from" the office or employment. In the past several explanations have been offered by judges of eminence as to the significance of the word "from" in this context… For my part, I think

> that their meaning is adequately conveyed by saying that, 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**." *[emphasis added]*

48. The next time their Lordships considered the question was in *Laidler v Perry* [1966] A.C. 16. In that case, a company gave £10 vouchers to many of its employees at Christmas every year. Its stated purpose was to "preserve and foster the good relations existing between the directors and staff". There was no contractual entitlement to the vouchers. Lord Reid said (at p32):

> "The real question appears to me to be whether these vouchers can be said to be mere personal gifts, inspired not by hope of some future quid pro quo from the done but simply by personal goodwill appropriately signified at Christmas."

49. The Special Commissioners had already found as a fact that "the vouchers were made available in return for services rather than as gifts not constituting a reward for services." Lord Reid observed that whilst the wording of this finding was perhaps "not very aptly chosen", it was "unassailable" and negated any possibility that the vouchers were personal gifts. As such, they could only therefore be emoluments from the employment.

50. Lord Morris was even more definitive (at p34):

> "The vouchers were not distributed to the staff workers on any individual or personal grounds nor were there any special or particular reasons which were peculiar to any of them. Though the impulses of generosity and of kindly and seasonal goodwill were not lacking, the facts as found show that there was manifested that form of gratitude which is "a lively sense of future favours". The directors were planning for good and loyal future service so that the company would prosper and be advantaged. In the result the vouchers were distributed by the employers in their capacity as employers and because they were employers; they were received by the employees in their capacity as employees and because they were employees. In these circumstances the emoluments were from the employment."

51. Lords Hodson, Morris and Pearson essentially agreed.

52. The next relevant decision of the House of Lords was in *Brumby v Milner* [1976] 3 All ER 636. In that case, a company had established a profit sharing scheme which made annual payments to employees. The company was then acquired by a larger group and it was considered impractical to continue with the scheme. The trustees therefore gave notice to terminate it and once all the scheme assets had been liquidated and its liabilities paid off, they determined to make a final capital distribution to existing and former employees of the company.

53. The House of Lords unanimously upheld the Court of Appeal's decision (and its underlying reasoning) that the capital payment made to one particular employee was an emolument from his employment and not (as he had argued) a fortuitous windfall that had arisen from the decision to wind up the profit sharing scheme rather than from his employment. As Lord Simon trenchantly put it (at p639):

> "It was conceded that payments to the instant taxpayer from the income of the trust fund arose relevantly from the taxpayer's employment. From what else did capital payment arise?"

54. The Court of Appeal's view was that the decisive question was:

> "…whether the payments now in question are properly to be regarded as a reward for and referable to services of the recipients."

55. In the House of Lords, both Lord Simon and Lord Kilbrandon referred with approval to Lord Reid's formulation in *Laidler v Perry:*

> '… we must always return to the words in the statute and answer the question—did this profit arise from the employment? The answer will be no if it arose from something else.'

56. It is also worth mentioning in passing that the Court of Appeal (approved by the House of Lords) were quite clearly of the view that payments to retired former employees would also be taxable as emoluments from their former employment: in their unanimous decision (given by Lord Russell at [1975] STC p650) they indicated that the payments were "rewards for and with reference to services" in part because "pensioned ex-employees, who ex hypothesi will be such because of the services they have rendered to the company, are brought into the class of recipients".

57. The next case on the topic before the House of Lords was *Tyrer v Smart* [1979] STC 34. In that case, a company was being floated on the Stock Exchange and employees with over 5 years' service were offered the opportunity to apply for shares on a preferential basis. The taxpayer took advantage of the opportunity and by the time he became entitled to the shares he had applied for, they were already worth £1,000 more than he had paid for them (though it would have been quite possible for them to have gone down in value). The key question to be determined was whether this profit was an emolument from his employment or arose as a result of a commercial decision on his part to invest in the company's shares.

58. The Special Commissioners had found as a fact that the company's purpose in making the shares available to its employees was to encourage established employees of the company and of companies within the group to become shareholders in the parent company. Its aim in doing so was:

> "to achieve a better relationship with the employees so that they would become and continue to be loyal employees…"

59. Lord Diplock (at p38) considered this to amount to:

> "a clear finding that the offer was made as a reward for past (since he had to have served five years to qualify for the offer) and more particularly for future services and accordingly was made to him in return for acting as or being an employee".

60. Neither Lord Diplock nor any of the other Law Lords felt able to overturn this finding – which they regarded as a finding of fact – and accordingly they were led inevitably to the conclusion that the profit made by the employee was taxable as an emolument from his employment – a conclusion which they all (to a greater or lesser extent) expressed themselves unhappy about.

61. In his introductory remarks, Lord Diplock summarised the current state of the authorities on the matter:

> "The test to be applied is well established. It is whether the benefit represents a reward or return for the employee's services, whether past, current or future, or whether it was bestowed on him for some other reason….
>
> Where the benefit is granted by and at the expense of the employer or its parent company, as distinct from benefits derived from third parties… the purpose of the employer in granting the benefit to the employee is an important factor in determining whether it is properly to be regarded as a reward or return for the employee's services. The employer's motives may be mixed and the determination of what constitutes his dominant purpose is a question of fact for the commissioners to determine."

62. In 1987, the Court of Appeal considered the area again in *Hamblett v Godfrey* [1987] STC 60. In that case, employees at GCHQ had various employment rights withdrawn from them (chiefly the right to belong to a trade union) and, in consequence of the changes they were offered a number of options. One of those options was to remain in service and receive what was described as an *ex gratia* payment of £1,000 in recognition of the loss of rights. The appeal concerned the taxability of that payment as an emolument from employment.

63. HMRC's difficulty in the case was that it was hard to characterise the £1,000 payment as being paid "as a reward for services past, present or future", or in exchange for the taxpayer "acting as or being an employee".

64. Nonetheless, after an extensive review of the earlier authorities, Purchas LJ summed up his view of the position as follows:

> "So, in my judgment, the approach that the court should take, and, indeed, that Knox J did in fact take, is to consider the status of the payment and the context in which it was made. The payment was made to recognise the loss of rights….
>
> The rights, the loss of which was being recognised, were rights under the employment protection legislation, and the right to join a union or other trade protection association. Both these rights, in my judgment,

> are directly connected with the fact of the taxpayer's employment. If the employment did not exist, there would be no need for the rights in the particular context in which the taxpayer found herself. So, I start from the position that those are rights directly connected with the employment….
>
> There is no doubt in this case that the employment protection legislation goes directly to the employment of the taxpayer with the employer. The right to join a union, in my judgment, also falls directly to be considered as in connection with that employment, because without the employment there is no purpose in joining the union… "

65. Neill LJ expressed the view (at p70) that Purchas LJ's examination of the authorities showed that "emoluments from employment are not restricted to payments made in return for the performance of services." Having avoided that apparent obstacle from the earlier authorities, he went on to say this:

> "It is plain that the taxpayer received her payment as a recognition of the fact that she had lost certain rights as an employee, and by reason of the further fact that she had elected to remain in her employment at GCHQ.
>
> Accordingly, if I may adopt the language of Lord Radcliffe *[in Hochstrasser]*… the payment to the taxpayer was made in return for her being and continuing to be an employee at GCHQ, or to use the words of Viscount Simonds *[also in Hochstrasser]*, 'the payment accrued to the taxpayer by virtue of her employment'….
>
> …The rights had been enjoyed within the employer/employee relationship. The removal of the rights involved changes in the conditions of service. The payment was in recognition of the changes in the conditions of service.
>
> 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 referrable to the employment and to nothing else."

66. In 1989, in *Bray v Best* [1989] BTC 102, the House of Lords had to consider a situation in which an employee benefit trust was wound up and cash distributions were made from it to individuals who had been in the employment of the relevant company ("Company A") until they had been transferred to an associated group company following a takeover. The taxpayer in this case had been employed by Company A for some twenty years and the Revenue sought to tax the payment as an emolument apportioned over the period of his employment (or alternatively as an emolument for the last tax year of his employment).

67. There had, before the lower courts, been some dispute as to whether the payment was an emolument from the taxpayer's employment. In the light of *Brumby*, however, the taxpayer accepted before the House of Lords that it was. There remained only one area of dispute. The taxpayer pointed out (and the House of Lords

agreed) that, to be taxable, the emolument must be "for" a tax year during which the employment from which it arose subsisted. On the facts of the case, he pointed out, the payment had actually been paid after his employment with Company A had ceased (as a result of the transfer of all employees to the other group company). As there was nothing to indicate that the payment was "for" any period during which his employment with Company A existed, the payment could only be charged to tax as a payment in connection with the termination of his employment (so benefiting from the £30,000 exemption).

68. The House of Lords agreed with the courts below that there was nothing to indicate that the payment could be regarded as a chargeable emolument "for" any tax year apart from the tax year in which it was paid. By the start of that tax year, the employment to which it related had ceased and therefore it could only be taxed under the termination payment provisions.

69. In doing so, Lord Oliver (with whom the other Law Lords agreed) briefly reviewed the case law on "emoluments from employment", and concluded that:

> "In the light of these authorities, I cannot read the phrase 'reward for services' as anything more than a conventional expression of the notion that a particular payment arises from the existence of the employer-employee relationship and not, to use Lord Reid's words in *Laidler v Perry*… from 'something else'."

70. In 1991, the House of Lords considered the area again in *Shilton v Warmhurst* [1991] 1 A.C. 684. This case was concerned with a payment made to a professional footballer by his existing club in order to induce him to accept a contract of employment with a new club. The key question was whether the payment could be regarded as an emolument from the new employment, even though it was paid by the old employer. The decision does not contain anything which will assist in the present appeal, beyond the following statement of the general principles derived from the authorities as follows:

> "Section 181 is not limited to emoluments provided in the course of employment; the section must therefore apply first to an emolument which is paid as a reward for past services and as an inducement to continue to perform services and, secondly, to an emolument which is paid as an inducement to enter into a contract of employment and to perform services in the future. The result is that 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'."

and a terse summary of the *ratio* of *Hamblett v Godfrey* as follows:

> "The Taxpayer received the £1,000 in recognition of the loss of rights that were not personal rights but were directly connected with her employment. The source of the payment was the employment."

71. In 1993, the House of Lords returned to the area again in *Mairs v Haughey* [1993] STC 569. That case was concerned with a composite payment made to employees of a shipyard in connection with its privatisation. Their existing contracts included a valuable non-statutory redundancy scheme, the cost of which was creating an obstacle to the privatisation process. The management made an offer to the employees of new terms of employment which would eliminate the scheme after a transitional period, in exchange for a payment made up of two elements. First, every employee would receive an immediate payment equal to 30% of the amount to which he would be entitled under the existing non-statutory redundancy scheme if he were made redundant. Second, there were some enhancements to the payment designed to improve the relative positions of those with either particularly short or particularly long service (who were considered to be unfairly disadvantaged by the flat 30% payment).

72. The Special Commissioner had decided that the composite payment could be apportioned; the flat rate 30% payment should be considered as compensation for loss of the non-statutory enhanced redundancy scheme and the remainder should be considered as attributable to the acceptance by the employees of new terms and conditions of employment. It appears to have been accepted by the taxpayer that this latter element was taxable as an emolument from his employment on that basis. The dispute therefore focused on the flat rate 30% element.

73. First, the Crown argued that it was inappropriate to carry out any apportionment; the whole payment should be regarded as an inducement to accept the new terms of employment, and accordingly taxable. The House of Lords (in an opinion delivered by Lord Woolf with which the other Law Lords agreed) held that the Commissioner had been entitled to find that the payment was apportionable.

74. As to the taxability of the 30% flat rate part of the payment, his Lordship held first that a payment made under a non-statutory redundancy scheme such as the one in this case would clearly not be an emolument from the employment; and the tax treatment of a payment made to compensate for the loss of the entitlement to such a payment should be treated in the same way for tax purposes. As he put it:

> "… 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…"

75. In reaching this conclusion, he considered it to be significant that the earlier authorities had stated that "payments… from a distress fund or to relieve distress" should not be regarded as emoluments from an employment (and he considered a

redundancy situation to be analogous); also, he noted that redundancy payments were paid after cessation of employment, and "prima facie a payment made after the termination of employment is not an emolument from that employment", unless an examination of the "substance of the matter" shows that such a payment in fact relates to the services rendered before termination. In general, however, payments under a bona fide redundancy scheme were properly viewed as compensation for loss of employment in particular circumstances, rather than emoluments from the employment.

76. The next occasion the matter came before the higher courts was in *EMI Group Electronics Limited v Coldicott* [1999] BTC 294, when the Court of Appeal considered the taxability of certain payments in lieu of notice.

77. The payments in question were payments made by the taxpayer to departing employees, whose contracts of employment reserved to their employer the right to terminate their employment without the normal notice period if it paid "the equivalent of the salary in lieu of notice".

78. Chadwick LJ, delivering the unanimous judgment of the Court of Appeal, had no difficulty in finding that "a payment in lieu of notice made in pursuance of a contractual provision, agreed at the outset of the employment, which enables the employer to terminate the employment on making that payment is properly to be regarded as an emolument *from* that employment." (at pp 300 and 309). In reaching that conclusion, he considered at some length the contrast between cases where the payment was made pursuant to the original terms of the employment contract and the cases where it was made pursuant to some later agreement.

79. Most recently, the Court of Appeal has revisited the general area in *Kuehne & Nagel Drinks Logistics Ltd v HMRC* [2012] EWCA Civ 34. In that case, a number of employees had their employment transferred from Scottish & Newcastle UK Limited to Kuehne & Nagel Drinks Logistics Limited (a joint venture company) in a transfer to which the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE") applied. Their pension rights were not preserved on the transfer, and under their new employment those rights were significantly less valuable. Industrial action was threatened, and ultimately payments of £4,800 were made to each employee, following negotiations. Judge Hellier in the First-tier Tribunal found that these payments "were made and received both (i) in order to compensate for the loss of pension expectations; and (ii) to ensure a 'smooth transfer'…". These two reasons for the payment were "not dissociable". He went on to say:

> "On this basis I conclude that the payment was taxable. Because it 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. 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 that the employees rendered and was in the nature of a reward or inducement for future willing service."

80. The Court of Appeal accepted this analysis. The key area of dispute in the case was around the implications of the Tribunal's finding that there were two reasons for the payment which were "not dissociable"; the Court of Appeal confirmed that if one of those reasons would characterise the payment in question as being an emolument from the employment, then as long as that reason was "sufficiently substantial" it would render the payment so taxable, irrespective of the other reason.

81. Finally, we consider it appropriate to consider *Mimtec Limited v IRC* [2001] STC (SCD) 101 in a little more detail. This was not a decision of the higher courts, but of the Special Commissioner (latterly President of this Tribunal) Stephen Oliver QC. It deserves special attention because it was relied on by the Appellant and it provides an example of the approach of the lower courts in applying the case law. It is, of course, not binding on this Tribunal.

82. *Mimtec* concerned the taxability (as emoluments) of payments received by employees made redundant "in recognition of any entitlements under the consultation process, including pay in lieu of notice, etc". The statutory redundancy provisions required the employer in that case (which was proposing to make more than 100 employees redundant) to enter into a 90 day consultation period before doing so. If it did not do so, an Employment Tribunal could make a "protective award", the consequence of which was that any affected employee was entitled "to be paid remuneration by his employer for the protected period". The employer was intending to carry out its redundancy programme well before the 90 day period expired and therefore it "paid off" the employees' entitlements to payments in respect of the early redundancies. The question was whether those payments were taxable as emoluments from employment.

83. First, the Special Commissioner agreed that the tax status of the payments should mirror the tax status of any payments of remuneration under a protective award. He then went on to consider that status.

84. He found that any such payments would be compensation for the failure to consult, and would not be "paid in return for acting as or being an employee". As such, they would not be emoluments from employment, even though the relevant statutory provisions described them as "remuneration":

> "The award is, as I interpret the provisions of the 1992 Act, compensation calculated by reference to remuneration that would otherwise have been paid for the 'protected period' had the employer gone through a proper consultation process and started consulting at the commencement of that period. The award is not, contrary to the argument for the Revenue, a payment in satisfaction of a right conferred on the employee by the 1992 Act to have his employment period extended by 90 days prior to the first dismissal. The 90 days is a component in the calculation of the compensatory award."

85. The Revenue also raised the argument, citing *Hamblett*, that the rights to a protective award and associated payments were so closely bound up with the employment that payments pursuant to those rights should be treated as emoluments

from the employment. The Commissioner distinguished the case from *Hamblett* as follows:

> "In contrast to the statutory rights to join unions etc. which are conferred on persons who are employed, the right to a protective award under the 1992 Act is given because the person in question… has been deprived of his employment by redundancy without proper consultation. The right to the award arises because the employer and employee relationship has been terminated. The 1992 Act is the source of the protective awards, not the employer and employee relationship."

Principles emerging from the case law

86. It is always necessary to address the statutory question, in this case: were the interim relief order payments "emoluments of the Appellant's employment?"

87. To assist in answering this question, a helpful general principle, as enunciated in *Hochstrasser* and subsequently approved many times, is that an emolument is "from" (or "of") an employment if it is "paid… in return for acting as or being an employee".

88. Some of the boundaries of this principle have been explored in the cases summarised above. The employment in question may be prospective, or with another employer (as in *Shilton*) or it may be past (as in *Brumby*). Payments made after cessation of an employment but pursuant to the terms of the former employment (as in *EMI*) are emoluments from (or of) the former employment. Payments to employees to compensate for the loss of rights directly connected with the employment (as in *Hamblett*) can also be emoluments from (or of) the employment.

89. By way of contrast, payments which are genuinely made as compensation for loss of employment are generally not emoluments from (or of) the employment. The exceptional feature in *EMI* which made such a payment an emolument from the employment was the fact that the terms of the employment specifically provided for it – the payment was made pursuant to the terms of the agreement on which the employee had originally agreed to serve.

90. Genuine redundancy payments, whether statutory or non-statutory (*Mairs*) are not taxable as emoluments from (or of) employment.

91. In general, a payment which is made to satisfy a contingent right to another payment will derive its character from the nature of the payment which it replaces, indeed "there will usually be no legitimate reason for treating the two payments in a different way" (*Mairs*).

Discussion

92. It is clear that the payments made to the Appellant pursuant to the interim relief order would not have arisen but for her employment. Such payments are also

clearly meant to provide a whistle blower with continuity of income. But does that mean that they should be taxed as emoluments of her employment?

93. The ERA specifically provides that when an interim relief order is made, "the contract of employment continues in force" for certain stated purposes, including pay and benefits. It could therefore be said that the contract of employment, as so continued, is the source of the subsequent payments – thus strengthening the argument that the payments are emoluments of the employment.

94. However, from our consideration of the cases referred to above, it is apparent that this analysis misses the point. The true question is not whether the payments arise from the employment contract, but whether they arise from the employment.

95. As a matter of law, it is quite clear that the Appellant's employment came to an end on 16 October 2009. It was only as a result of the termination of her employment that she became entitled to claim interim relief. When that relief was granted, it did not have the effect of reinstating her employment, it merely entitled her to receive certain payments and other benefits equivalent to what she would have received if the employment had continued. The character of those payments as compensation payments (rather than emoluments of the employment) is clearly contemplated in the provisions of section 130 ERA, under which:

> "… any payment under that subsection *[i.e. pursuant to an interim relief order]* in respect of a period goes towards discharging any liability of the employer under, or in respect of breach of, the contract of employment in respect of that period".

It is also quite clear that rights under s 129 and 130 ERA can only arise after an employment has ceased, which militates strongly against treating any payment under those provisions as emoluments "from" (or "of") the relevant employment.

96. So is there any other basis on which the interim payments could be said to amount to emoluments of the Appellant's employment?

97. It is true to say that the whistle blower rights, like the rights under the employment protection legislation in *Hamblett*, are "directly connected with the fact of the taxpayer's employment". However, in *Hamblett* the payment in question was made in the context of a continuing employment, which is a very different situation from the present. Also, if this argument were taken to its logical conclusion, an employee's rights not to be unfairly or wrongfully dismissed have a similarly close connection with any employment, which would potentially render taxable as an emolument all payments made in satisfaction of those rights. This is clearly not the case. In short, like the Special Commissioner in *Mimtec*, we do not consider the reasoning in *Hamblett* can be applied to the present situation.

98. Similarly, the "replacement principle" relied on by Mr Boal might be argued as meaning that the interim relief payments, being intended to replace normal taxable earnings, should attract the same tax treatment. Again, we consider this argument to be unsustainable, for the following reasons:

(1) First, the replacement principle has only been applied in the past to assist in deciding the tax treatment of a payment made voluntarily or by agreement between the parties to replace some lost contingent right. In this case, the obligation to make the payment is imposed pursuant to statute – or, to put it another way, the source of the payments was, in our view, not the employment but a combination of two things, namely the loss of employment and the operation of the statutory whistle blower rights.

(2) Also, Mr Boal's "replacement" argument effectively assumes what it seeks to prove – that is to say, it assumes the interim relief payments have the nature of earnings when it could equally validly (if not more validly) be said that they have the nature of compensation for loss of employment.

99. For all these reasons, we therefore conclude that the payments to the Appellant were not emoluments of her employment.

100. We consider it appropriate to test this conclusion by reference to other situations which would potentially arise where interim relief orders might be made. It is, for example, instructive to consider what the position would have been if the Appellant had not obtained interim relief but had instead simply obtained compensation for her wrongful and unfair dismissal, either by negotiation or after an Employment Tribunal hearing. In that situation, the first £30,000 of any payment received by her would clearly have been exempt from income tax. Why should her position be different simply because she has received that £30,000 in monthly instalments by way of interim relief rather than in a lump sum? We can see no good reason.

101. And what if she had lost her employment tribunal claim altogether? Clearly in that situation, it would not be correct to categorise the interim payments she had received in the meantime as damages for her dismissal. This may be true, but it is not in our view relevant. Her employment would still have terminated, and given the way in which ITEPA is framed, the interim payments would still undoubtedly fall within s 401 as having been "received directly or indirectly in consideration or in consequence of, or otherwise in connection with…the termination of [her] employment", and therefore exempt from income tax up to £30,000 (but taxable thereafter).

102. Thus the tax treatment of the payments works logically on the basis of our analysis of them, and there is nothing arising from this examination of related situations to suggest that our analysis is flawed.

103. We should also consider the practicalities, not least for the guidance of employment tribunals and employers making and complying with orders for interim relief payments in the future. It follows from our analysis that the first £30,000 of any payments made to a former employee pursuant to an order for interim relief should, in the absence of some special factor, be paid free of income tax. It should therefore not have income tax deducted from it under the PAYE system, and the order for interim relief should not be phrased in terms which contemplate such deduction in respect of the first £30,000 paid pursuant to the order.

Summary and conclusion

104. We do not consider the payments made to the Appellant pursuant to the interim relief order to be emoluments of her employment, rather they were "received… in consequence of, or otherwise in connection with… the termination of her employment".

105. They are accordingly taxable only to the extent they exceed £30,000

106. The appeal is therefore ALLOWED.

107. 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.

KEVIN POOLE
TRIBUNAL JUDGE

RELEASE DATE: 9 July 2014