



**Appeal number FTC/36/2010  
[2010] UKUT 431 (TCC)**

*Income Tax: redundancy payment: earlier payment as compensation for variation of contractual redundancy arrangements: subsequent redundancy: whether earlier payment counts for purposes of exemption from and liability for income tax; Income Tax (Earnings and Pensions) Act 2003 s403; Income and Corporation Taxes Act 1988 s148 & 188*

**UPPER TRIBUNAL  
TAX AND CHANCERY CHAMBER**

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

**Appellant**

**- and -**

**KENNETH COLQUHOUN**

**Respondents**

**TRIBUNAL: J GORDON REID QC, F.C.I.Arb (Judge)  
KENNETH MURE QC**

**Sitting in public in Edinburgh on 11 October 2010**

**Party for the Appellant**

**Iain Artis , advocate for the Respondents**

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## DECISION

### Introduction

- 5 1. This is an appeal by the Commissioners of Her Majesty's Revenue and Customs  
(HMRC) against the decision of the First-tier Tribunal (the FTT) dated 14 January  
2010. Their decision arose out of an appeal by the taxpayer, Kenneth G  
Colquhoun (Mr Colquhoun) against an amendment to his self assessment return  
10 for the year to 5 April 2006. The broad issue is whether a payment made to Mr  
Colquhoun in 1997 of some £33,000 in respect of a change to his contractual  
redundancy entitlement is to be taken into account when assessing his income tax  
liability when he was eventually made redundant in 2005 and received a  
redundancy payment in excess the exempt sum of £30,000. The resolution of this  
15 issue depends upon the correct interpretation of section 148 of the Income &  
Corporation Taxes Act 1988 ("ICTA") and its successor provisions in ss401-403  
of the Income Tax (Earnings & Pensions) Act 2003 ("ITEPA")
2. The appeal was heard at Edinburgh on 14 October 2010. Sean Smith, advocate,  
appeared on behalf of HMRC, and Mr Colquhoun represented himself. Each  
20 party produced a Skeleton Argument.

### Legislation

- 25 3. Sections 148(1)&(2), 188(4)-(6) ICTA, and section 403(1) (within Chapter 3 of  
Part 6) ITEPA are set out at paragraphs 23,24 and 26 of the FTT's Decision. The  
critical provision is s148(2) which provides that tax is to be charged under  
Schedule E in respect of any payment made to an employee or former employee

30 *which is made, whether in pursuance of any legal obligation or not, either  
directly or indirectly in consideration or in consequence of, or otherwise in  
connection with, the termination of the holding of the office or employment or  
any change in its functions or emoluments, including any payment in  
commutation of annual or periodical payments (whether chargeable to tax or  
not) which would otherwise have been so made.*

- 35 4. It should be noted that there are transitional provisions which apply such that  
references in sections 403(4) &(5) and 404(3)(b) ITEPA to payments or benefits  
to which Chapter 3 of Part 6 applies include references to payments and benefits  
to which section 148 ICTA applied (see ITEPA Schedule 7, Transitional and  
40 Savings, Part 6, paragraph 43).

### Background Facts

- 45 5. Mr Colquhoun was employed by Rosyth Royal Dockyard plc, part of the the  
Babcock Group of companies to whom the Ministry of Defence sold the  
dockyard. There were negotiations between the Ministry, employers and trade  
union representatives about the funding of current redundancy packages. It was

agreed that each employee would receive a “buy-out payment”, and in return the existing redundancy scheme would be phased out. Paragraph 5 of the FTT decision found as fact that the arrangements in relation to Mr Colquhoun included the following:-

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“The amount of the buy-out payment to which Mr Colquhoun became entitled was £33,148.71; and on 21 July 1996, Mr Colquhoun signed a form of acknowledgement in the following terms-

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“The buy-out payment above is in respect of a change to contractual redundancy entitlements only. All other terms and conditions of employment remain unchanged.

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I accept the above buy-out payments as compensation in full for my agreement to a change in my contractual redundancy entitlements as outlined in Mr AK Smith’s letter of 18 July 1996 .....

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6. In about January 1997, Mr Colquhoun received the buy-out payment (£33,148.71). An advice note from his employer showed that £30,000 was being treated as non-taxable and £3,148.71 was being aggregated with his salary for tax purposes. No tax was deducted from the sum of £30,000 (see paragraph 6 and of the FTT’s Decision).

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7. Mr Colquhoun was made redundant with effect from 31 August 2005. His redundancy entitlement statement disclosed a payment in lieu of notice of £29,664.00 and a redundancy payment of £61,930.59 (total £91,594.59). In his amended self assessment return Mr Colquhoun has sought a deduction of £30,000. HMRC opened an enquiry into his return and amended it so as to bring the deduction back into charge (see paragraphs 8-10 of the FTT’s Decision)

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### **The FTT Decision**

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8. As it had been conceded by HMRC that in 1996/97 there had been no termination of Mr Colquhoun’s office or employment, no change in functions or emoluments and no commutation of annual or periodic payments, the FTT concluded that s148(2) did not apply. In the FTT’s view, *it would be stretching too far the taxation provision of that section if a payment to a continuing employee were to give rise to a charge to tax under Schedule E merely because the payment related to a change in the employee’s contractual redundancy entitlement which were (sic) in any case wholly contingent upon a future redundancy.* Whatever the reason for £30,000 not being taxed in 1997 that did not arise from the operation of section 188(4)ICTA. The whole exemption referred to in s403(1) ITEPA was therefore available to be set against the redundancy payment received in 2005 (see paragraphs 39 and 40 of the FTT Decision)

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## Submissions on Appeal

### *HMRC*

- 5 9. Mr Smith submitted the FTT's interpretation of s148(2) was too restrictive. The  
provision was, as originally enacted, a piece of widely drawn anti-avoidance  
legislation to which a significant list of payments was excluded. A payment in  
10 lieu of redundancy was not within the list. The payment received in January 1997,  
made in substitution for redundancy, should be regarded as having the same  
character as redundancy payments and treated in the same way. Parliament could  
have excluded such substitutionary payments but did not do so. Section 148(2)  
does not require actual termination. It is sufficient that the payment was made *in*  
*connection* with the termination whether or not that event occurs. Moreover, there  
15 was no requirement of contemporaneity between the payment and the termination.  
Mr Smith developed these arguments in some detail and referred to *Walker v*  
*Adams 2003 STC (SCD) 269*, and *Mairs v Haughey 66 TC 273*.

### *Mr Colquhoun*

- 20 10. Mr Colquhoun supported the reasoning of the FTT and submitted that the 1997  
was not a substitute for a redundancy payment. The employers' paperwork  
showed that the payment was made to reduce a balance sheet liability and there  
was no dependence on any future action for its payment. The premise upon which  
HMRC's arguments proceed is unfounded. Section 148(2) is concerned with  
25 actual not possible redundancy. Contemporaneity or its absence was irrelevant. It  
is difficult to make a connection with a termination when no employee is  
dismissed. The payment was not made in connection with the termination of  
employment and could not be related to a redundancy. HMRC accepted it was not  
a redundancy payment. Mr Colquhoun referred us to the Board of the Inland  
30 Revenue's General Notes on that part of the Finance Bill which dealt with  
Compensation for loss of office and other payments on retirement. Under  
reference to this material, he submitted that Parliament's intention was to enact a  
*catch-all* provision where termination had occurred. *Mairs* concerned actual  
termination, and to statutory redundancy payments made at the time of  
35 termination.

## Discussion

### *Structure of relevant statutory provisions*

- 40 11. The essentials of the statutory provisions with which we are concerned were  
originally enacted in section 37 of the Finance Act 1960 as an anti-avoidance  
measure to bring within the charge to income tax a variety of arrangements which  
made provision for payments as compensation for loss of office, in commutation  
of pension rights, in relation to changes in terms of employment and similar  
45 arrangements. The statutory scheme then, as now, provided for a threshold (then  
£5000 and now £30,000) and a long list of exemptions to the payments caught by  
the anti-avoidance provisions. The exemptions were contained in s188 ICTA and

are now to be found in ss405-414 ITEPA. It is inherent in the scheme that aggregation will apply where more than one payment has been made.

- 5 12. The statutory language of section 148(2) has been broadly drawn. That can be  
seen from the use of words and phrases such as *indirectly* and *otherwise in  
10 connection with*. *Otherwise* may simply mean *in any way* and is consistent with  
the Parliamentary intention to catch a wide range of payments. In *Walker* a  
compensation payment awarded for constructive dismissal of a former employee  
fell within the charge to the extent that it related to loss of income but not to the  
15 extent that it compensated for injury to feelings. Special Commissioner O'Brien  
observed (in an appeal relating to s148 ICTA) that *The word "otherwise" shows  
that the relevant connection or link may be looser than would be required for a  
strict causation test*. While we are not entirely clear what is meant by a *strict  
causation test* we agree with the general sentiment that the word *otherwise* does  
20 not restrict the scope of section 148(2) and is entirely consistent with a broad  
approach to the application of the phrase *in connection with*. As Mr Smith  
submitted, the language could hardly be less prescriptive.

#### *Termination and Contemporaneity*

- 20 13. The FTT concluded that as there was no actual termination in 1997 there could be  
no charge under s148. We disagree. It is not necessary to read the phrase *the  
termination* as meaning *a termination* that is to say an event which must have  
occurred at or about the time the payment in question is made. An individual's  
25 employment will always terminate eventually either by dismissal, death or  
retirement (on account of age or some other reason)
- 30 14. A payment connected with the termination of employment is treated as income  
received on the date of the termination in respect of which the payment was made  
(s148(4)(b)). Thus, the possibility is envisaged that payment and actual  
termination may not occur contemporaneously. If that is so, then payment and  
termination need not be within the same tax years. There is nothing in the  
legislation which limits the period between payment and actual termination. This  
35 is consistent with the broad structure of the legislation discussed above.

#### *Mairs v Haughey*

- 40 15. This case was cited to the FTT and to us for the proposition that a payment made  
in exchange for a right to payment should derive its character from the nature of  
the payment it replaces. Lord Woolf, who gave the only reasoned speech, said at  
page 343G-H:-

45 It is inevitable that if a payment is made in substitution for a  
payment which might, subject to a contingency, have been  
payable that the nature of the payment which is made in lieu will  
be affected by the nature of the payment which might otherwise

have been made. There will usually be no legitimate reason for treating the two payments in a different way.

16. Lord Woolf returned to this theme at page 347C where he said

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As already indicated, the payment made to satisfy a contingent right to a payment, derives its character from the nature of the payment which it replaces.

10 17. The FTT sought to distinguish *Mairs* on the ground that there was an actual  
*redundancy situation* and the payment arose at the time Mr Haughey's  
employment with Harland & Wolff came to an end. While these may be  
distinguishing facts, they do not dilute the applicability of the underlying principle  
set forth by Lord Woolf. Whether Lord Woolf's observations set forth a principle  
15 or presumption does not matter for present purposes as we consider it to be prima  
facie applicable and not rebutted by the facts found by the FTT. Accordingly, a  
payment made to satisfy a contingent right to a redundancy payment will normally  
derive its character from the nature of the payment it replaces. Here, as the FTT  
found as fact (paragraph 5), the payment was for Mr Colquhoun's agreement to a  
20 change in his contractual redundancy entitlements. It takes its character from a  
redundancy payment which might have been payable, and such a payment falls  
within the scope of the charge to tax under section 148.

#### *Other Arguments*

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18. We consider that what may have been shown on the balance sheet of Mr Colquhoun's employers at the time to be of no significance. We have not identified any discussion or finding of fact about this matter in the FTT's decision.

30 19. We do not consider it legitimate to refer to the Board of the Inland Revenue's  
General Notes on that part of the Finance Bill which dealt with compensation for  
loss of office and other payments on retirement (see *Scottish Widows plc v HMRC*  
*2010 CSIH 47 28/5/10 paragraphs 62-64*). Even if we had taken these Notes into  
account our decision would have been the same.

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#### **Conclusions**

20. In our view, the FTT fell into error (i) by considering that *termination* meant an  
actual termination, and consequently that there had to be contemporaneity  
40 between the payment and the termination and (ii) by failing to apply or apply  
properly the observations of Lord Woolf in *Mairs*, which we consider to be  
relevant and applicable to the circumstances of Mr Colquhoun's appeal.

21. If the FTT's decision were correct, a payment in lieu of redundancy would not be  
45 taxable as an emolument or under section 148 ICTA (now 403 ITEPA); this  
would plainly be contrary to the intention of the scheme enacted by Parliament.

## **Result**

22. We allow the appeal. The HMRC amendment to Mr Colquhoun's self-assessment  
return is reinstated. We invite submissions on expenses in writing within twenty  
5 eight days of the release of our Decision. In the absence of such submissions, no  
order for expenses will be made.

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**J GORDON REID QC, F.C.I.Arb**  
**JUDGE OF THE UPPER TRIBUNAL**  
**RELEASE DATE: 6 December 2010**

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