TC02986

Appeal number: TC/2012/11102

INCOME TAX – Appellant incurred costs in claim for unfair dismissal in Employment Tribunal, Employment Appeal Tribunal and Court of Appeal and was ordered to pay Respondents costs in Court of Appeal – whether such costs were deductible expenses under s 336 Income Tax (Earnings and Pensions) Act 2003 – No – Appeal Dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MICHAEL WARDLE **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN BROOKS
IAN PERRY

Sitting in public at Eastgate House, Newport Road, Cardiff on 24 September 2013

Martyn Arthur, of Martyn F Arthur Forensic Accountant Ltd, for the Appellant

John Corbett of HM Revenue and Customs, for the Respondents

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DECISION

1. Mr Michael Wardle appeals against a closure notice issued by HM Revenue and Customs ("HMRC") in respect of his 2010-11 self-assessment tax return, under s 28A of the Taxes Management Act 1970, on 23 August 2012. The closure notice, which increased Mr Wardle's liability to income tax by £49,136.98, was upheld by HMRC following a review and Mr Wardle's representative, Mr Martyn Arthur of Martyn F Arthur Forensic Accountant Limited (who appeared before us), was notified of this in a letter dated 8 November 2012. The effect of the amendment was, in essence, to deny a deduction made by Mr Wardle, from his earnings, of:

(1) the costs he incurred in bringing a claim against his former employers for unfair dismissal which proceeded through the Employment Tribunal, the Employment Appeal Tribunal and the Court of Appeal; and

(2) the costs of the respondent that he was required to pay in accordance with an order of the Court of Appeal.

The grounds of appeal were that:

> HMRC's decision is based on an unsound hypothesis and is neither sustainable in law, nor on the arguments adduced by HMRC

2. Although we were provided with a bundle of documents prepared by HMRC (which included the decision of the Employment Tribunal in the proceedings taken by Mr Wardle against his former employers) as it had been stated by Mr Arthur in an email to the Tribunal on 10 May 2013 (and repeated in his letter to the Tribunal, dated 23 May 2013 attached to his email of the same date) that no witnesses were to be called on behalf of the appellant who would be "relying on HMRC's bundle of documents", we requested further clarification regarding the litigation between Mr Wardle and his former employers.

3. Following a brief adjournment for this purpose, the parties produced a schedule of agreed facts which we have appended to this decision. However, having produced the schedule of agreed facts but before making any submissions Mr Arthur requested that the case be adjourned to enable Mr Wardle to make a witness statement and to enable him (Mr Arthur) to properly prepare for the hearing. This application was opposed by Mr Corbett on the grounds that the issue to be determined was straightforward and there was no reason for any further delay.

4. After a further adjournment for consideration and having regard to the overriding objective to deal with a case fairly and justly under Rule 2 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, which includes "avoiding delay, so far as compatible with proper consideration of the issues", we came to the conclusion that the application for a further adjournment should be refused.

5. We have already referred to the email and letter from Mr Arthur to the Tribunal dated 10 and 23 May 2013 respectively, in which it was stated that it was not intended to call any witnesses and he would "be relying on HMRC's bundle of documents".

6. Also, notice of the hearing had been sent to the parties on 18 June 2013. In the circumstances we were satisfied that the parties had been given adequate time to prepare for the hearing and, having been provided with the schedule of agreed facts, we were also satisfied that we were able to give proper consideration to the issues concerned.

Facts

7. The factual background to this appeal is as set out by Elias LJ, with whom the other Court of Appeal judges agreed, in *Wardle v Credit Agricole Corporate and Investment Bank* [2011] ICR 1290; [2011] EWCA Civ 545 at [3] to [6] which, although we were not provided with a copy of the judgment by the parties, we gratefully adopt:

> 3. [Mr Wardle] The claimant was employed by Calyon in a post with the interesting designation of Global Head of Exotic Interest Rate Derivatives Risk Management. He applied to be promoted to Head of Risks Management but the application failed and a French national obtained the post. Had the claimant been promoted, the new job would have taken effect from January 2008. The rejection of his application for promotion was held to be an act of discrimination on the grounds of nationality, which contravenes the Race Relations Act 1976. The claimant was subsequently dismissed with effect from 31 July 2008. The Tribunal held that this dismissal was both unfair and an act of victimisation discrimination under the 1976 Act in that the reason for dismissal was a protected act, namely the fact that he had commenced the promotion proceedings in the Tribunal alleging discrimination under that Act.
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> 4. In its judgment on remedy, the Employment Tribunal made certain findings which informed its assessment of compensation. The material findings were as follows:
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> i) The claimant's salary at the time of his dismissal was £104,000.
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> ii) If he had been promoted to Head of IRD Risk Management his salary would have increased from £104,000 to £120,000.
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> iii) In that role he would have received a bonus in each of the years 2009 and 2010 of 70% of his salary. (No express finding was made with respect to later years.)
>
> iv) The claimant secured employment with the Financial Services Authority (FSA) on 3rd November 2008 at a salary of £105,000 (paragraph 26). The FSA would also pay a bonus in that year and thereafter but only of 20% of salary.
>
> v) This job involved a significant reduction both when compared with what he was earning and what he would have earned had he not been denied his promotion. However, the Tribunal found that the FSA job qualified him well for a return to banking. The Tribunal said this (para 29):

> 'The Claimant was recruited as part of the FSA's drive to recruit experienced and talented people from the private sector at higher salaries than were normally paid in the public sector. Although his title is Associate, it was quite clear when he described to us the details of the job he carries out that it is a job at a fairly high level. He acts as a consultant and goes into banks and reviews their risk operations. He assesses their risk practices and whether they have adequate capital and does stress testing. He has meetings with Chief Risk Officers in the large banks and has first hand experience of seeing how things work at the board level. He has experience of and insight into the relationship between the Bank of England and the FSA. The Claimant is diligent and ambitious and we have no doubt that he will quickly learn and master his new role and that he will do well in it. The experience he will gain and the contacts that he will make from his job will stand him in good stead should he decide to go back into a career with a bank in a market risk / regulatory role. With increased regulatory drives, a risk manager who has regulatory experience as well is likely to be in demand.'

vi) The Tribunal then made certain findings on two matters which figure significantly in this appeal. The first was what would have happened to the claimant had he not been dismissed. The Tribunal noted that the claimant's previous working history showed that in the previous 15 years he had worked for four different employers and that the longest he had stayed with any single employer was five years. It observed that the banking crisis of late 2008 was likely to be resolved by an improvement in market conditions, and that the claimant still had contact with head hunters. In the light of these factors it found that there was:

> "a very strong chance, which we put as high as 80%, that the Claimant would have left the Respondent's employment at the beginning of April 2010, having collected his loyalty premiums."

vii) The second concerned the likelihood of the Claimant leaving the FSA and returning to his banking career. The Tribunal's analysis of this reflected much of what it had already said about the prospects of going back into banking (para 36). This is an important paragraph in this appeal and I set it out:

> "We next considered the likelihood of the Claimant leaving the FSA and returning to a better paid role in banking. The Claimant has worked for 20 years (the greater part of his working life) in banks, and appears to have had little difficulty in finding new jobs and moving from one bank to another. He had a successful career in trading and risk management. The only reason that he had difficulty in finding a job in banking

> in late 2008 was because of the extraordinary circumstances that prevailed at that time in the financial services sector. We accept that the Claimant will remain at the FSA for some time so that he can derive the full benefits of learning new skills and gaining experience as a regulator. Having done so, he will be well equipped to return to a risk management/regulatory role in banking. As we have said before, the indications are that in the future regulatory work and risk management will pay a larger part in the role of banks. The Claimant, having had experience of both risk management and regulatory procedures and controls from within the FSA, will be in a good position to seek a high level post within the banking sector. He is also in his current role in a good position to make useful contacts with senior risk officers and managers in banks. The Claimant is diligent and ambitious and will not resign himself to a post where his earnings are lower if there is a potential for him to move into better paid work. Having carefully considered all the evidence it is our conclusion that after the Claimant has been with the FSA for about a period of three years, i.e. at the end of 2011, there is a 70% chance that he will return to banking and be able to secure employment in banking that will pay at the same salary level as he enjoyed before. We took into account that the Claimant will be aged 47 at that time."

I refer hereafter to a job in banking at the same salary level as the claimant would have enjoyed if promoted as "equivalent employment".

viii) The Tribunal then considered whether Calyon had complied with the statutory procedural obligations imposed upon them, both with respect to a grievance raised by the claimant when he was not promoted, and when he was dismissed. The Tribunal held that the grievance had been dealt with in accordance with the relevant procedures, albeit somewhat ineptly, but that there had been a fundamental failure to comply with the dismissal procedure. As to the latter, the Tribunal said this (para 40):

> "We next considered whether we should uplift any award of compensation for the dismissal on the ground that the statutory dismissal and disciplinary procedure had not been completed. The statutory procedure requires the employer to inform the employee in writing of the grounds that have led the employer to contemplate dismissing the employee, to inform him of the basis for those grounds, and then when the employee has had reasonable time to consider that information to hold a meeting with him to discuss the matter and thereafter to make a decision on whether to dismiss the employee. In the present case, the Claimant

> was suddenly called into a meeting and was told that he was being dismissed immediately. There was no step one letter and no step two meeting to discuss matters before reaching a decision. The meeting that took place was to inform the Claimant of a fait accompli, it was not a step two meeting. The Respondent is a large employer with huge resources available to it. It knew what the procedures were, it made a conscious and deliberate decision to ignore them. There was no good reason why the procedure could not have been followed. In those circumstances, we think it just and equitable to uplift any award we make by 50%."

5. Having made these findings, the Tribunal then assessed compensation by considering the losses suffered by the claimant in various distinct chronological periods:

i) It assessed the claimant's loss between January and July 2008 based on comparing his actual pay with the pay he would have received if he had been appointed to the Head of IRD Risk Management position (paragraph 42).

ii) It also assessed loss from the end of his employment until he obtained a job with the FSA on the same basis (paragraph 43).

iii) For the period between 3rd November 2008 (when his employment at the FSA commenced) and 1st April 2010 (when the Tribunal had assessed that there was an 80% chance that he would go elsewhere), the Tribunal calculated the claimant's loss by reference to pay he received in his role at the FSA compared with what he would have received had he been promoted (paragraph 44-45).

iv) In relation to the period 2nd April 2010 to 31st December 2011 (the point at which the Tribunal found there was a 70% chance that he would obtain an equivalent job), the Tribunal adopted the same approach in determining loss but it reduced the sum so calculated by 80% to reflect its conclusion that there was an 80% chance that the claimant would leave Calyon in April 2010 (paragraph 46).

v) It then awarded compensation for the whole of the period 1st January 2012 to 31st December 2024 which was the date when it found that he would retire. In effect therefore, it was calculating this head of loss by reference to the whole of the claimant's career. It again made this calculation by reference to the difference between the pay earned at the FSA compared with what the claimant would have received had he carried out the equivalent job, and then it reduced that sum by reference to the findings it had already made as to the likelihood that the claimant would still have been employed by the FSA during that period. First, it reduced it by 80% to reflect its conclusion that there was an 80% chance he would have left Calyon in April 2010; and then it reduced that sum by a further 70% to reflect its conclusion that there was a 70% chance that at the end of 2011 he would return to banking in equivalent employment (paragraphs 47-48). The consequence was that only 6% of the total difference in pay throughout that period was awarded.

vi) The Tribunal added certain additional heads of loss, including a small sum for loss of statutory rights, and £15000 for injury to feelings. (This in fact included £5000 aggravated damages which the EAT subsequently held had been wrongly awarded.)

vii) The Tribunal applied a 50% uplift to the total sum calculated. These were all net payments. The overall loss was assessed at almost £180,000 net of tax, and the uplift was half of that. After grossing up, the total award was almost £375,000.

At this point I simply note that although this was not an illogical way of calculating the loss, it did not in terms distinguish the loss flowing from the dismissal from that which flowed from the discriminatory failure to promote.

The appeal to the EAT.

6. Both parties appealed aspects of the Tribunal's judgment to the EAT. The conclusions of the EAT with respect to those grounds of appeal which are now the subject of further appeal to this court can be summarised as follows:

(i) The EAT allowed the claimant's appeal against the Tribunal's decision that the compensation awarded for the period after April 2010 should be reduced by 80% (or indeed by any amount) to reflect its conclusion that there was an 80% chance that he would have left Calyon's employment in April 2010 (paragraphs 15-18). The EAT considered that this was an irrelevant finding because it did not help identify the claimant's loss. It should have had no bearing on the assessment of compensation.

(ii) The EAT dismissed Calyon's appeal that the Tribunal had been wrong to award career long loss at all (paragraph 24). Contrary to the submissions of Calyon, it held that the exercise was not too speculative and that the Employment Tribunal had had enough evidence to make a sensible prediction about the claimant's future.

(iii) The EAT allowed Calyon's appeal that having found that there was a 70% chance that the claimant would have obtained an equivalent job by the end of 2011, the Tribunal ought to have increased the reduction in respect of years subsequent to 2011 to reflect the fact that the 70% chance must have improved with each passing year (paragraphs 26-27). Indeed, the EAT considered that there was no answer to the appellant's submission on this point. The EAT then went on to determine for itself how the chances would increase. It did so by taking two later dates, namely 2015 and 2019, and calculating the likelihood of equivalence being achieved by that date. It concluded that the discount for the years 2011 to 2015 should stay at 70%; for the years 2015 to 2019 it should increase to 85%; and for the years 2020 to 2024 it should be 92.5%.

(iv) The EAT allowed Calyon's appeal against the uplift of 50% and substituted a figure of 10% (paragraphs 46-47). The EAT held, contrary to the submissions of Calyon, that the Employment Tribunal had been entitled to say that the gravity of the procedural breach would in a normal case justify the maximum 50% uplift, but it concluded that

> the Employment Tribunal had erred in failing to have regard to the very significant size of the award overall. The EAT held that following the reasoning of the decision of the Court of Appeal in *Abbey National v Chagger* [2010] ICR 397, this was a material misdirection entitling it to substitute its own conclusion. The additional compensation had to be proportionate and the payment of an extra £90,000 was wholly disproportionate. The EAT held that in the circumstances the uplift should be reduced to 10% before grossing up the tax.
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> (v) The EAT however rejected the argument that the employment tribunal had erred in law in applying the uplift to heads of damage in respect of which there had been no breach of procedures. The contention was that the uplift should apply to that part of the compensation which was attributable to the claimant's dismissal only and should exclude that which was attributable to the discriminatory failure to promote him, since with respect to the latter the Tribunal had found that there was no breach of procedure. The EAT held that given the substantial link between the discriminatory refusal to promote and the dismissal, the Tribunal was entitled to find that it was just and equitable to apply the uplift to the whole of the award.

8. The Court of appeal dismissed Mr Wardle's appeal and set aside the employment tribunal's award of compensation and substituted an award of £315,396.14. The Court of Appeal also ordered Mr Wardle to pay the respondents cost of the appeal and 80% of the respondents costs of its cross-appeal "to be subject to detailed assessment is not agreed."

9. However, detailed assessment was not necessary as the respondents accepted Mr Wardle's offer to pay £66,057.53 in respect of their costs. In addition Mr Wardle paid his own legal costs amounting to £197,702.62 claiming a deduction for £240,000 in his 201-11 self-assessment tax return but correcting the total amount to £263,760.15 in his letter of 23 July 2012 to HMRC.

10. Details of what was required of Mr Wardle when employed by Caylon can be found in the decision of the Employment Tribunal, released on 3 June 2009, at [15]. This states:

> "[Mr Wardle's] job description sets out his main responsibilities as follows – on a daily basis to monitor market activity, review the positions taken by the exotic risk takers and changes to the positions and to communicate with senior management; on a periodic basis to review the risks taken by the business and the reward for taking those risks or new methodologies; and to be responsible for change management by challenging the status quo, promoting change and co-ordinating the transformation of methodologies, measurements and processes with the business and support area. A key component of his function was the maintenance and validation of the reconciled stress tests, and his job also required to the setting of Reserves and reserve methodology for the books and maintaining knowledge of the underlying markets through reserves … The post-holder needed to be able to explain high level trading risk for the portfolio for which he

> was responsible. The role also involved co-ordination with various departments and required someone who understood the business."

Legislation

11. Insofar as it is applicable s 336 of the Income Tax (Employment and Pensions) Act 2003 ("ITEPA") provides:

> (1) The general rule is that a deduction from earnings is allowed for an amount if—
>
> (a) the employee is obliged to incur and pay it as holder of the employment, and
>
> (b) the amount is incurred wholly, exclusively and necessarily in the performance of the duties of the employment.

Summary of submissions

12. Mr Arthur submitted that Mr Wardle was a financial regulator who in the performance of his duties was required to consult solicitors and therefore costs incurred were deductible as part of his employment. He contended that this applied to those costs Mr Wardle had incurred while still employed. As for subsequent costs Mr Arthur argued that these should be treated as part and parcel of the employment costs and in the performance of the duties of his employment because Mr Wardle had been successful in his case against his former employers and the sum awarded was compensation for unfair dismissal. Similarly the respondents costs were also linked to the case and should also be deductible.

13. Mr Corbett, for HMRC, did not accept Mr Wardle had been employed by Caylon as regulator saying that such a suggestion was not supported by the decision of the Employment Tribunal.

14. After referring us to *Lomax (HM Inspector of Taxes) v Newton* (1953) 34 TC 558, where Vaisy J had said (at 562) of Rule 9 of schedule E of the Income Tax Act 1918 which, like s 336 ITEPA, allowed for the deduction of expenditure incurred "wholly, exclusively and necessarily in the performance" of the taxpayer's duties that:

> "The words are indeed stringent and exacting; compliance with each and every one of them is obligatory if the benefit of the Rule is to be claimed successfully."

Mr Corbett submitted that because Mr Wardle's costs had been arisen after his dismissal these could not fall within s 336 ITEPA as he could not have been obliged to incur the costs as a holder of the employment neither were the costs incurred wholly, exclusively and necessarily in the performance of the duties of the employment.

Discussion and Conclusion

15. It is clear from the description, by the Employment Tribunal, of the responsibilities of Mr Wardle's employment with Caylon (which we have quoted at

paragraph 10, above) that he was not employed as a financial regulator by Caylon. Although we accept that he did subsequently gain such experience with the FSA the costs he incurred which are the subject matter of this appeal are not attributable to Mr Wardle's role as a regulator but as a result of his dispute with, and subsequent unfair dismissal from, Caylon.

16. As such these costs may only be deducted from his earning if they fall within the conditions of s 336 ITEPA.

17. This requires Mr Wardle to have been obliged to pay the costs as a "as holder of the employment" and for the amount to be incurred "wholly, exclusively and necessarily in the performance of the duties of the employment".

18. However, given the nature and duties of Mr Wardle's employment with Caylon we are unable to find that he was either obliged to meet his legal costs and those ordered by the Court of Appeal as a holder of the employment or that they were incurred wholly, exclusively and necessarily in the performance of the duties of the employment. It must therefore follow that these costs cannot be deducted from Mr Wardle's earnings and HMRC were correct to make the amendment to his 2010-11 self-assessment tax return.

19. Accordingly, we dismiss his appeal.

Right to Apply for Permission to Appeal

20. 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.

JOHN BROOKS
TRIBUNAL JUDGE

RELEASE DATE: 22 October 2013

Appendix

Schedule of Facts
(agreed and prepared by the parties on 24 September 2013)

May 2008	Engaged solicitors concerning the conduct of your [Mr Wardle's] work
July 2008	Dismissed
Approx. August – September 2008	Internal Procedure
Approx. May 2009	Appeal Lodged Employment Tribunal (grievance letter Lodged whilst still employed)
Approx. September 2009	Award £374,000 no order for costs
Approx. June 2010	Both parties appealed to Employment Appeal Tribunal Additional award of £125,000
March 2011	Both parties appealed to Court of Appeal Award reduced by £150,000
11/05/11	award for costs – agreed subsequently approx. £66,000