



TC04950

Appeal number: TC/2015/02682

INCOME TAX – payments on termination of employment contract – whether payments subject to tax as general earnings within section 62 Income Tax (Earnings and Pensions) Act 2003 – no – whether subject to tax under section 401 Income Tax (Earnings and Pensions) Act 2003 – yes – whether payment should be apportioned between tax years – no – appeal allowed in part

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

MICHAEL PHILLIPS

Appellant

- and -

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

**TRIBUNAL: JUDGE ASHLEY GREENBANK
CATHERINE FARQUHARSON**

Sitting in public at Norwich on 3 November 2015

The Appellant in person

Justin Kruyer, officer of Her Majesty's Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by the Appellant, Mr Michael Phillips, against a closure notice
5 in respect of the tax year ended on 5 April 2013 issued by the Respondents, HMRC, on 9 January 2015.

2. The closure notice raised an assessment on Mr Phillips for income tax in the amount of £14,844.04 in respect of amounts paid to Mr Phillips by his former employer, ISG Construction Limited (“ISG”), pursuant to a compromise agreement
10 (the “compromise agreement”) dated 2 October 2012 made between ISG and Mr Phillips relating to the termination of his employment with ISG.

The hearing and evidence

3. HMRC produced a bundle of documents for the hearing. The Appellant produced a bundle of additional documents.

4. At the hearing, we heard submissions from the Mr Kruyer on behalf of HMRC
15 and submissions and oral testimony from Mr Phillips. We found Mr Phillips to be a credible witness and we accepted his evidence.

5. The evidence before us at the hearing did not contain any details of the terms of the contract between Mr Phillips and his former employer, ISG, or the compromise agreement. We asked Mr Phillips to provide copies of his employment contract and
20 the compromise agreement following the hearing.

6. In response to our request, Mr Phillips provided a copy of the compromise agreement and a copy of a letter dated 31 July 2001 from Jackson Building Limited to Mr Phillips, which sets out the terms of an offer of employment made by Jackson Building Limited to Mr Phillips. Mr Phillips informed the Tribunal that ISG was in
25 the same group as Jackson Building Limited and his employment contract was transferred to ISG at some point after 2001, but the terms of his employment have remained substantially the same except that at some point his notice period was changed from three months to six months. We have accepted Mr Phillips’s evidence.

7. The submissions of HMRC did not, in our view, properly address the basis of taxation of the various payments made to Mr Phillips under the compromise agreement. We asked HMRC to clarify those submissions in written submissions
30 following the hearing.

8. In response to our request, HMRC submitted a further bundle of containing
35 further authorities, copies of legislation, a copy of Mr Phillips’s tax return for the tax year ended 5 April 2014 and a calculation of Mr Phillips’s income tax liability for that year.

9. As a result of certain administrative errors on the part of the Tribunal, HMRC's further bundle was not forwarded to the members of this Tribunal for some time. In the interim, we issued further directions requiring HMRC to make any submissions on or before 31 December 2015. Those errors have since come to light. However, the result has been a delay in the production of this decision and some inconvenience to the parties for which we can only apologise.

10. We also allowed HMRC to amend or make further submissions following receipt of the documents from Mr Phillips (to which we have referred at paragraph [6] above). HMRC confirmed that the documents did not affect their submissions.

10 **Facts**

11. On the basis of the documents and of the oral testimony of Mr Phillips, we find the facts as set out below.

12. Mr Phillips was employed as the finance director of Jackson Building Limited in 2001. The terms of his employment are set out in a letter dated 31 July 2001 from Jackson Building Limited to Mr Phillips. That letter provided that Mr Phillips's employment could be terminated "on 3 months' notice by either party or such longer period as defined by the Employment Rights Act 1996 as amended by subsequent legislation". The letter did not contain any other provisions regarding the termination of Mr Phillips's employment. It did not make any provision for payment in lieu of notice.

13. Jackson Building Limited changed its name several times during the course of Mr Phillips's employment. At some point, Mr Phillips ceased to be employed by Jackson Building Limited (as it had been known) and became employed by ISG Construction Limited ("ISG"), a company in the same group as Jackson Building Limited.

14. There is a reference in other documentation to a contract dated at some time in 2005. However, we have not seen a copy of any employment contract between Mr Phillips and ISG. Mr Phillips says that the terms of his employment remained substantially the same throughout the period of his employment with the group except that, at some point, the period of notice was extended from three months to six months. We have accepted his evidence. We have therefore proceeded on the basis that, subject to increases in salary and the increase in the notice period, the terms of Mr Phillips's employment with ISG were the same as the terms of his employment with Jackson Building Limited as set out in the letter dated 31 July 2001.

15. In 2012, Mr Phillips was informed that his contract would be terminated. On 2 October 2012, he entered into the compromise agreement with ISG to terminate his employment contract.

16. The compromise agreement provided, amongst other things:

(1) for Mr Phillips's employment to terminate with effect from 31 January 2013;

(2) for Mr Phillips to be required to work between the date of the compromise agreement and the date of termination of his employment;

5 (3) for Mr Phillips's benefits under his contract of employment to continue until the termination of his contract on 31 January 2013 (subject to certain exceptions);

(4) for the following payments to be made to Mr Phillips within 28 days of the later of (i) 31 January 2013; (ii) the receipt by ISG of a completed copy of
10 the compromise agreement and the independent adviser's confirmation and (iii) the return of various items of property to the company:

(i) a payment of £15,000 "(including statutory redundancy entitlement) as compensation for loss employment, damages for breach of contract and in respect of any award or damages to which [Mr
15 Phillips] would be entitled in the Employment Tribunal, County or High Court arising out of his employment or its termination";

(ii) the sum of £47,521 "by way of payment in lieu of notice and accrued annual leave (subject to deduction of tax and national
20 insurance contributions and employee pension contributions)";

(iii) the sum of £2,924.82 "into [Mr Phillips]'s pension with the company pension scheme (representing six months worth of employer contributions and national insurance rebate)"; and
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(iv) a payment of £100 in respect of certain undertakings given by Mr Phillips.

17. The compromise agreement was expressed to be in full and final settlement of
30 all claims that Mr Phillips might have against ISG and Mr Phillips waived any claims under various aspects of employment law against ISG.

18. The compromise agreement was signed by Mr Phillips, a witness and on 10 October 2012, by a solicitor for Stewarts Law LLP which confirmed that Mr Phillips had been given independent advice on the terms of the settlement, although it is not
35 clear to us the Mr Phillips received any advice on the tax consequences of the settlement agreement.

19. The copy of the compromise agreement that we have seen was not signed by ISG. Mr Phillips explained that he was advised by the personnel director of ISG that it was not the company's policy to sign the employee copy of the compromise
40 agreement.

20. The payments referred to in paragraph [16] above, were made to Mr Phillips on 31 January 2013. The sums of £15,000 and £100 were paid to Mr Phillips without

deduction of tax and national insurance contributions. The sum of £47,521 was paid subject to deduction of tax and national insurance contributions.

21. On 9 April 2013, ISG submitted its annual return of payments made to Mr Phillips in the tax year 2012/13 (Form P14). That return shows total payments made to Mr Phillips in the tax year of £104,554.60 and the amount of tax deducted at source as £40,783.18. The Form P14 did not include any reference to the payments of £15,000 and £100 made to Mr Phillips without deduction of tax.

22. On 22 July 2013, Mr Phillips submitted a tax return for the tax year 2012/13. The return was received by HMRC on 25 July 2013. The tax return showed (i) redundancy and other lump sum and compensation payments of £15,100; (ii) total pay from employment of £76,505; and (iii) total tax deducted at source of £40,783. The return also showed some small amounts of gift aid payments and dividends received, but these items are not relevant to this appeal.

23. In his return Mr Phillips explained the breakdown of the tax-free payments. He also included a calculation to justify the figures of taxable employment income shown in his tax return and a reconciliation of those numbers against the figures shown in his Form P60 (and his employer's Form P14). In summary, for the purposes of his tax return, Mr Phillips allocated the payment of £47,521 made to him under the compromise agreement "by way of payment in lieu of notice and accrued annual leave" partly to the tax year 2012/13 and partly to the tax year 2013/14 by apportioning the full amount pro-rata across what would have been a six month notice period so that one-third of the payment, £15,840 (representing two months of the notice period), was allocated to the tax year 2012/13 and two-thirds of the payment, £31,681 (representing 4 months of the notice period), was allocated to the tax year 2013/14.

24. Mr Phillips drew HMRC's attention to his calculation in the white space on his tax return and asked if the overpayment of tax (on his calculation) should be refunded or set against his liabilities for 2013/14.

25. There followed a chain of correspondence between Mr Phillips and HMRC. We have only seen copies of the letters from Mr Phillips to HMRC, being letters dated 1 September 2013 and 9 October 2013. However, following that correspondence, HMRC made payments to Mr Phillips in repayment of tax overpaid for the tax year 2012/13 in the aggregate amount of £14,863.45. This figure is broadly in line with Mr Phillips's calculation as submitted with his tax return.

26. As part of the correspondence, Mr Phillips supplied a copy of the tax return submitted on 22 July 2013 and which had been received by HMRC on 25 July 2013. HMRC have referred in subsequent correspondence and in submissions to this Tribunal to the copy of the return which Mr Phillips supplied as part of this correspondence as an amended return. Mr Phillips submitted that this was not correct. There was no amendment; the return was simply a copy of his original return which he re-submitted at the request of HMRC. We found Mr Phillips's evidence on this

point the more compelling and, to the extent that it is relevant, we find as a fact that Mr Phillips did not amend his return for the tax year 2012/13.

27. On 1 July 2014, HMRC wrote to Mr Phillips to notify Mr Phillips that HMRC would be enquiring into Mr Phillips's tax return for the tax year 2012/13. The letter referred to the discrepancy between the figures shown in Mr Phillips's tax return and the information contained in his employer's Form P14 and asked Mr Phillips to provide information to support his original calculation.

28. HMRC did not receive a reply. On 8 August 2014, HMRC wrote to Mr Phillips again. The letter requested response from Mr Phillips by 22 August 2014.

29. On 15 August 2014, Mr Phillips wrote to HMRC. He explained that he had not received the letter dated 1 July 2014. He expressed some surprise at the enquiry into his tax return and pointed out that his return had been reviewed on several occasions before the repayment of tax had been made. He asked for reasons why his tax return was thought to be incorrect.

30. On 4 September 2014, Ms Bevan of HMRC wrote to Mr Phillips. She asked for more information in order to complete the enquiry into his return.

31. On 9 September 2014, Mr Phillips replied. He enclosed with his letter copies of the correspondence in 2013 which had led to the repayments together with a copy of his tax return for the tax year 2012-13.

32. On 25 September 2014, Ms Bevan wrote to Mr Phillips. She informed Mr Phillips that she would be contacting his former employer in order to clarify the discrepancy between the figures in Mr Phillips's tax return and those shown in his employer's returns.

33. On that date Ms Bevan wrote to ISG. She requested certain information relating to the figures shown in the Form P14 relating to the payments made to Mr Phillips in the tax year 2012-13. The information that she requested included: a breakdown of the payments made to Mr Phillips and the tax deducted; a confirmation of what each payment related to; details of any tax-free element paid to Mr Phillips; confirmation that the tax-free element had not been included in the Form P14; the method of payment; and confirmation that the Form P14 that was submitted showed the correct figures. Ms Bevan's letter did not include any request for documents evidencing the terms of Mr Phillips's employment or the details of the compromise agreement.

34. On 23 October 2014, ISG responded to Ms Bevan providing the details that she had requested. That letter, in effect, confirmed the information that ISG had provided in the Form P14.

35. On 6 November 2014, Mr Hopley, technical officer of HMRC, wrote to Mr Phillips. He informed Mr Phillips that the reply from ISG had confirmed that the payment in lieu of notice was taxable and that Mr Phillips's total taxable salary for the tax year 2012/13 was therefore £104,554.60. He confirmed that he intended to make the appropriate amendments to Mr Phillips's tax return.

36. On 18 November 2014, Mr Phillips replied refuting the revised assessment. He set out his understanding of the tax treatment of the various payments that had been made to him.

5 37. On 19 December 2014, HMRC wrote to Mr Phillips to confirm his assessment and notified Mr Phillips that it would be arranging for the tax return to be amended.

38. On 9 January 2015 HMRC issued a closure notice to Mr Phillips enclosing an amended tax return showing employment income of £104,554 and tax due of £40,873. The letter requested a payment from Mr Phillips of £14,884.04 being the amount HMRC said had been overpaid to Mr Phillips together with interest to 8 January 2015.

10 39. On 25 January 2015 Mr Phillips wrote to HMRC to appeal against the closure notice. In that letter, he summarized his arguments as follows:

“My argument is therefore:

15 (a) The payment made to me by ISG was partly in payment of my notice, for the period 6 April 2013 – 31 July 2013. Such a payment (in accordance with my contract of employment) should not fall into the tax year and should therefore not be subject to income tax in that year, 2012/13.

(b) I was not in a position to influence the date on which the payments were made to me.

20 (c) It is perverse that I should be assessed for an additional tax liability which is considerably in excess of any liability which would have been due had my contract of employment been allowed to run its contractual course.

(d) The assessment of my income for 2012/13 would appear to be unreasonable and contrary to the rules of natural justice.”

25 40. On 16 February 2015, HMRC wrote to Mr Phillips to offer a review of the decision and the closure notice. Mr Phillips did not take up that offer.

41. On 12 March 2015, Mr Phillips wrote to HMRC and the Tribunal to notify his appeal against the closure notice. The grounds of his appeal were set out in the letter, but in substance, were the same as those set out in his letter of 25 January 2015.

30 42. Mr Phillips sent a formal notice of appeal to the Tribunal dated 1 April 2015. This attached a further letter, also dated 1 April 2015, setting out his grounds of appeal. Those grounds were the same as those set out in his letter of 25 January 2015.

Issues before the Tribunal

43. The issues before the Tribunal were:

35 (a) how should the payments made to Mr Phillips under the compromise agreement be taxed, as general earnings under section 62 of the Income Tax

(Earnings and Pensions) Act 2003 (“ITEPA”) or as a payment in connection with the termination of Mr Phillips’s employment under section 403 ITEPA; and

(b) in which tax year does any tax charge on those payments arise?

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The parties’ arguments

44. Neither Mr Phillips nor Mr Kruyer, on behalf of HMRC, directly addressed the first issue in their submissions.

45. Mr Phillips says:

10 (a) He was paid a sum instead of being allowed to work out his contractual notice period. The amount of the payment was calculated by reference to the payments to which he would have been entitled if he had been allowed to work for that period.

15 (b) If he had been allowed to work out his contractual notice period, the greater part of the payment would have been received in the tax year 2013/14.

(c) If the entire amount of the payment is taxed in the tax year 2012/13, he suffers a significant increase in his overall tax liability on the payment.

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(d) That is a perverse result given that he had no control over the timing of the payment. It is the action of his employer, ISG, in terminating his contract that results in a higher tax liability.

25 46. Mr Kruyer for HMRC says:

(a) Mr Phillips’s tax return for the tax year 2012/13 was not consistent with the Form P14 submitted by his employer, ISG.

30 (b) There was nothing in the information provided by his employer that suggested that any repayment was due to Mr Phillips.

(c) In the absence of any evidence to the contrary, the full amount of the payments made to Mr Phillips other than the redundancy payment of £15,000 is subject to income tax as general earnings in the year in which it was received, that is the tax year 2102/13.

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Taxation of payments under the compromise agreement

47. We will turn first to the question of how the payments made under the compromise agreement are taxed.

Legislation

48. Part 2 of ITEPA imposes the charge to tax on “employment income”. Section 6 ITEPA provides that the charge to tax on “employment income” is a charge to tax on “general earnings” and “specific employment income”.

5 49. The definition of “general earnings” is found in section 7(3) ITEPA. It provides that “general earnings” means “earnings within Chapter 1 of Part 3” and certain other amounts treated as earnings by sub-section (5) of section 7 excluding, in both cases any “exempt income”. The amounts within section 7(5) (which include amounts taxed under the benefits code) are not relevant for the purposes of this appeal.

10 50. The definition of “earnings” for the purposes of Chapter 1 of Part 3 ITEPA is found in section 62 ITEPA. It provides so far as relevant:

“(1) This section explains what is meant by “earnings” in the employment income Parts.

15 (2) In those Parts “earnings”, in relation to an employment, means

(a) any salary, wages or fee,

20 (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 (3) For the purposes of subsection (2) “money's worth” means something that is -

(a) of direct monetary value to the employee, or

30 (b) capable of being converted into money or something of direct monetary value to the employee.”

51. Section 7(4) ITEPA provides that “specific employment income” means “any amount which counts as “employment income” (see sub-section (6)), excluding any exempt income”. Section 7(6) provides that the reference in sub-section (4) includes, among other things, any amount which counts as employment income by virtue of Part 6 of ITEPA.

52. Part 6 of ITEPA is entitled “Employment income: income which is not earnings or share-related”. Chapter 3 of Part 6 is headed “Payments and benefits on termination of employment, etc.”. Chapter 3 contains sections 401 to 416.

40 53. Section 401 is headed “Application of this Chapter” and provides as follows:

“(1) This Chapter applies to payments and other benefits which are received directly or indirectly in consideration or in consequence of, or otherwise in connection with:

- 5 (a) the termination of a person's employment,
10 (b) a change in the duties of a person's employment, or
15 (c) a change in the earnings from a person's employment,
by the person, or the person's spouse or civil partner, blood relative,
dependant or personal representatives.
- (2) Subsection (1) is subject to subsection (3) and sections 405 to 413 (exceptions for certain payments and benefits).
- (3) This Chapter does not apply to any payment or other benefit chargeable to income tax apart from this Chapter.”

20 54. Section 403(1) ITEPA provides:

“Charge on payment or other benefit

- 25 (1) 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 threshold.”

30 55. The effect of section 403 ITEPA is that any payment above the £30,000 threshold which falls within section 401 counts as employment income and is chargeable to income tax subject to any other allowances and reliefs.

56. Section 403(4) provides that, in calculating the £30,000 threshold, all payments that fall within Chapter 3 must be aggregated in accordance with the rules in section 404.

35 57. Section 404 provides, among other things, that such payments to an employee or former employee in respect of the same employment are to be aggregated even if they are received in different tax years.

Case law

40 58. It is clear from section 401(3) ITEPA that, where the choice is between whether a payment is taxed as general earnings under Chapter 1 of Part 3 ITEPA or under Chapter 3 of Part 6 ITEPA, the charge under Chapter 1 of Part 3 ITEPA takes priority. So the first issue to determine is whether a payment amounts to “general earnings”.

59. There is a significant amount of case law in this area. Much of that case law is in the context of legislation which was in effect before the enactment of ITEPA. Under the previous legislation, the main charge to tax on employment-related income was the charge on “emoluments” in paragraph 1 of Schedule E, which immediately
5 prior to the enactment of ITEPA was found in section 19 of the Income and Corporation Taxes Act 1988 (“ICTA”).

60. The concept of “emoluments” was replaced in ITEPA with the concept of “earnings”. The definition of “earnings” in section 62(2) ITEPA follows much of the definition of “emoluments” in section 131 ICTA. It also includes “anything else that
10 constitutes an emolument of the employment” (see sub-paragraph (c)). The explanatory notes for the introduction of ITEPA (in Annex 2 Note 13) suggest that this wording is intended to ensure that the pre-existing case law can apply to include within the concept of “earnings” anything which would have been regarded as an “emolument” but which was not listed in the definition in section 62(2)(a) and (b).

15 61. As we have discussed, the parties did not direct our attention to any of the case law on this subject. We do not therefore intend to embark upon an exhaustive survey of the applicable law. We have however, set out below some of the key principles derived from the case law as we understand it, which we have taken into account in reaching our decision.

20 62. In deciding whether a payment is an “emolument” of the employment, it is necessary to determine whether the payment is derived “from” the employment: in other words, whether or not the payment is paid to the employee for “acting or being an employee” (see the judgment of Lord Radcliffe in *Hochstrasser (Inspector of Taxes) v Mayes* [1960] AC 376 at page 392) or “for being or becoming an employee”
25 (see the judgment of Lord Templeman in *Shilton v Wilmshurst (Inspector of Taxes)* [1991] AC 684 at page 689).

63. In the context of payments made in connection with the termination of employment, the case law suggests that, where the employer makes a payment in lieu of notice to an employee pursuant to a term of the contract of employment which
30 gives the employer the option to terminate either by giving a period of notice or making the payment, the payment may not be wages or salary, but it is an “emolument” of the employment. The payment in such a case is derived from the employment because it is part of “the security, or continuity, of salary which [the employee] required as an inducement to enter into the employment” (see Chadwick LJ in *EMI Group Electronics Limited v Coldicott (Inspector of Taxes)* [1999] STC
35 803 at page 811) and so must be regarded as “earnings”. This is the case whether that term was part of the contract of employment from the outset (as in *EMI Group Electronics Limited v Coldicott*) or whether it was introduced by a subsequent amendment (for example, as in *SCA Packaging Limited v Revenue & Customs Commissioners* [2007] EWHC 270 (Ch)).
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64. On the other hand, subject to one reservation to which we refer below, a payment that is made to terminate or abrogate completely a contract of employment is

not an “emolument” and so will not be “earnings” within section 62(2) ITEPA. This was the case, for example, in *Henley v Murray (Inspector of Taxes)* (1950) 31 TC 351. In that case, the employee, Mr Henley, had a contract of employment under which he was to serve to a fixed date, after which the contract was subject to termination by three months’ notice. The employer and employee agreed to terminate the contract in return for a lump sum payment. The members of the Court of Appeal, by slightly different routes, came to the conclusion that the payment was not an emolument and so not subject to tax under Schedule E.

65. The one reservation to which we refer is that certain members of the Court of Appeal in that case indicated that their decisions may not have been the same if the employer and employee had come to a mutual agreement to terminate the employment contract pursuant to which a sum was paid to the employee (see the comments of Sir Raymond Evershed MR (1950) 31 TC 351 at page 360 and Somervell LJ at page 367). As explained by Lightman J in the *SCA Packaging* case, those comments cannot have been a reference to every case in which the employment contract is terminated by agreement between the employer and the employee given that such an agreement was in place in *Henley v Murray* itself. Those comments have to be taken to refer to “an amicable unforced termination, and, in particular, such a termination not initiated by the employer” in the words of Lightman J in his judgment in *SCA Packaging* (at paragraph [131]).

Discussion

66. In the present case, Mr Phillips was entitled to six months’ notice under his contract of employment. The contract did not make any provision for payment in lieu of notice.

67. Mr Phillips was told by his employer, ISG, that his employment was going to come to an end. ISG and Mr Phillips entered into an agreement in October 2012 to terminate Mr Phillips’s employment with effect from 31 January 2013. The compromise agreement was entered into approximately four months before the date on which it was agreed that Mr Phillips’s employment would terminate. Mr Phillips was paid his salary and received his other benefits under his contract of employment during the period to 31 January 2013.

68. The effect of the compromise agreement was that ISG and Mr Phillips agreed to terminate the employment contract at a fixed date in the near future at which point, subject to the fulfilment of certain conditions, Mr Phillips would receive various payments, one of which was calculated by reference to the period of notice set out in his employment contract. In the interim, Mr Phillips continued to work under the terms of his existing contract of employment.

69. Even though Mr Phillips continued to work for ISG in the period to 31 January 2013, it is clear to us that the compromise agreement is an agreement terminating entirely Mr Phillips’s contract with ISG. ISG was not entitled to terminate Mr Phillips’s employment contract under the terms of that contract by making a payment in lieu of notice. The payments under the compromise agreement were made to Mr

Phillips in compensation for the abrogation for his contractual rights. Although Mr Phillips and ISG entered into the compromise agreement to enshrine the terms on which his employment would come to an end, the termination of Mr Phillips's employment took place at the instigation of Mr Phillips's employer. This was not a case of "an amicable unforced termination".

70. On that basis, in our view, the payments made to Mr Phillips under the compromise agreement fall within the principles set out in *Henley v Murray*. Whatever label the payments are given, they are not "emoluments" of the employment and so are not "earnings" within section 62(2) ITEPA. It is not relevant that the amount of the payments was calculated, in part, by reference to the salary that Mr Phillips might have earned had he continued to be employed throughout a period of notice that he was never given. That was simply a means of calculating the compensation that was paid to him. It does not affect the nature of the payment.

71. For these reasons, in our view, the payments made to Mr Phillips under the compromise agreement are not "earnings" within section 62(2) ITEPA. This reasoning applies equally to the payment of £15,000 expressed to be paid to Mr Phillips as compensation for loss employment, to the payment of £100 expressed to be paid to Mr Phillips in consideration for the undertakings that he gave in the compromise agreement and to the sum of £47,521 paid to Mr Phillips expressed to be by way of payment in lieu of notice.

72. Those payments are, however, all payments made in connection with the termination of Mr Phillips's employment and so fall within section 401 ITEPA. As we have mentioned at paragraphs [54] and [55] above, section 403(1) ITEPA brings into charge as employment income any amounts that fall within section 401 to the extent that they exceed a threshold of £30,000.

73. By virtue of section 403(4) and section 404 ITEPA, any amounts that fall within section 401 and that relate to the same employment are aggregated in calculating the £30,000 threshold even if they are paid in different tax years. The effect in this case is therefore that, of the total amount of £62,621 that was paid to Mr Phillips, £30,000 is exempt from income tax as employment income and the balance of £32,621 is taxable under Chapter 3 of Part 6 ITEPA.

Timing of the tax charge

74. We turn next to the timing of the tax charge.

Legislation

75. Section 9 ITEPA defines the amount of employment income that is charged to tax. So far as relevant, it provides:

"(1) The amount of employment income which is charged to tax under this Part for a particular tax year is as follows.

- (2) In the case of general earnings, the amount charged is the net taxable earnings from an employment in the year.
- 5 (3) That amount is calculated under section 11 by reference to any taxable earnings from the employment in the year (see section 10(2)).
- (4) In the case of specific employment income, the amount charged is the net taxable specific income from an employment for the year.
- 10 (5) That amount is calculated under section 12 by reference to any taxable specific income from the employment for the year (see section 10(3)).
- (6) Accordingly, no amount of employment income is charged to tax under this Part for a particular tax year unless –
15
 - (a) in the case of general earnings, they are taxable earnings from an employment in that year, or
 - 20 (b) in the case of specific employment income, it is taxable specific income from an employment for that year.”

76. Section 10 ITEPA explains what is meant by “taxable earnings” and “taxable specific income” for a particular tax year. It provides, subject to certain exceptions, that “taxable earnings” from an employment for a tax year are to be determined in accordance with Chapters 4 and 5 of Part 1 ITEPA (section 10(2)); and that “taxable specific income” from an employment for a tax year means the full amount of any specific employment income which, by virtue of Part 6, 7 or 7A or any other enactment, counts as employment income for that year (section 10(3)).

77. We have concluded that the payments fall to be taxed as specific taxable income within Chapter 3 of Part 6 ITEPA and not as general earnings. So we do not need to consider the timing rules for a tax charge on “taxable earnings”.

78. The timing of the tax charge for any amounts of specific taxable income falling within Chapter 3 of Part 6 ITEPA is dealt with in section 403 ITEPA. It provides:

- 35 “(1) 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 threshold.
- (2) In this section “the relevant tax year” means the tax year in which the payment or other benefit is received.
- 40 (3) For the purposes of this Chapter –
 - (a) a cash benefit is treated as received -
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 - (i) when it is paid or a payment is made on account of it, or

(ii) when the recipient becomes entitled to require payment of or on account of it, and

5 (b) a non-cash benefit is treated as received when it is used or enjoyed.”

Discussion

79. Section 403(1) ITEPA provides that an amount of specific employment income that falls within Chapter 3 of Part 6 ITEPA counts as employment income in the
10 “relevant tax year” if and to the extent that it exceeds the £30,000 threshold. In the case of a cash payment, the relevant tax year is either the tax year in which it was paid or the tax year in which the recipient became entitled to require payment to be made (section 403(2)).

80. In the present case, the payments under the compromise agreement were made
15 to Mr Phillips in the tax year 2012/13. He became entitled to them in the same tax year. The relevant tax year is therefore the tax year 2012/13.

81. On this issue, therefore, while we understand the logic of Mr Phillips’s argument and appreciate the force with which he made it, we agree with Mr Kruyer.
20 If and to the extent that the payments under the compromise agreement exceed the £30,000 threshold, they are taxable in the tax year 2012/13.

Decision

82. We allow this appeal in part.

83. On the issues before the Tribunal, in our judgment:

25 (a) the payments made to Mr Phillips under the compromise agreement are subject to tax under Chapter 3 of Part 6 ITEPA and not as general earnings;

(b) if and to the extent that they exceed the £30,000 threshold in section
30 403(1) ITEPA, those amounts are taxable in the relevant tax year, which was the tax year 2012/13.

84. On that basis:

(a) of the aggregate amount of £62,721 paid to Mr Phillips on 31 January
35 2013, the sum of £32,721 is subject to tax in the tax year 2012/13;

(b) no part of that amount is taxable in the tax year 2013/14;

(c) the closure notice should be amended to show earnings from Mr Phillips’s employment of £89,554 for the tax year 2012/13.

85. We assume that our decision on these issues will enable the parties to agree between them any balance due from Mr Phillips to HMRC or vice versa. In the event of any further disagreement, the parties can reapply to the Tribunal.

Rights of appeal

5 86. 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
10 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.

15 **ASHLEY GREENBANK**
TRIBUNAL JUDGE

RELEASE DATE: 7 MARCH 2016