



[2021] UKFTT 156 (TC)

**08125**

*INCOME TAX AND NATIONAL INSURANCE CONTRIBUTIONS* -- change to terms and conditions of the pension scheme – payment to employees – whether *Tilley v Wales* applied – replacement principle – whether payment “from” the employment – appeal refused

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**Appeal numbers: TC/2019/06938  
TC/2019/06945**

**BETWEEN**

**E.ON UK PLC**

**Appellant**

**-and-**

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

**Respondents**

**TRIBUNAL: JUDGE ANNE REDSTON**

**The hearing took place on 18 and 19 February 2021 by video. A face to face hearing was not held because of restrictions caused by the pandemic.**

**Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media and/or members of the public could apply to join the hearing remotely to observe the proceedings. The hearing was therefore held in public.**

**Mr Jolyon Maugham QC and Ms Georgina Hicks of Counsel, for the Appellant**

**Mr Charles Bradley of Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

## DECISION

### INTRODUCTION AND SUMMARY

1. E.ON UK plc (“E.ON”) is a well-known supplier of power and gas. In mid-2018, some 1,100 of its employees were members of a “retirement balance” type of pension scheme. Under retirement balance schemes, a notional amount is accumulated each year, which can be used on retirement to provide a lump sum and/or to pay a pension. The employee contributes to the notional amount by deduction from his salary, and the employer guarantees to make up the balance.

2. In 2018, E.ON’s retirement balance arrangements changed, and scheme members were paid a one-off lump sum called a “Facilitation Payment”. This was 7.5% of salary, subject to a minimum payment of £1,000.

3. It was E.ON’s case that the Facilitation Payments were exempt from income tax and National Insurance Contributions (“NICs”) because they were not “from” the employment within the meaning of the Income Tax (Earnings and Pensions) Act 2003 (“ITEPA”), s 9(2) and the Social Security Contributions and Benefits Act 1992 (“SSCBA”), s 3(1).

#### **Mr Brotherhood**

4. E.ON asked HMRC for a ruling that the Facilitation Payments were not taxable or subject to NICs, but HMRC did not agree. After some discussion, E.ON paid tax and NICs on all the Facilitation Payments other than that of one “test” employee, a Mr Jason Brotherhood, a member of the retirement balance scheme.

5. HMRC issued E.ON with a determination of £758 under Reg 80 of the PAYE Regs in respect of the Facilitation Payment made to Mr Brotherhood, and on the same day a decision under Reg 8 of the Social Security (Transfer of Functions) Act 1999 (“SS(ToF)A”), charging NICs of £987.07.

6. It was common ground that the facts of Mr Brotherhood’s case and those of other retirement balance members were substantially the same, except in relation to quantum. HMRC accepted in correspondence with E.ON that if it was successful in its appeal before the Tribunal, the tax and NICs on the Facilitation Payments of other retirement balance members would be refunded.

#### **The final salary scheme**

7. At the same time as changing the retirement balance scheme, E. ON also changed its traditional final salary scheme, and paid Facilitation Payments to members of that scheme. However, the changes made to the final salary scheme were not identical to those made to the retirement balance scheme: for example a cap was placed on future pensionable earnings, but no similar restriction applied to members of the retirement balance scheme. HMRC nevertheless agreed to repay the tax and NICs on Facilitation Payments paid to members of the final salary scheme if E.ON succeeded in its appeal in relation to Mr Brotherhood.

8. I pointed out to the parties that I only had the jurisdiction to hear the appeal which had actually been made. That concerned the Facilitation Payment made to Mr Brotherhood. There was no appeal against tax or NICs charged on a Facilitation Payment made to a member of the final salary scheme. I therefore had no jurisdiction to make findings of fact and law about those Facilitation Payments, and I have not done so. However, in the course of

the hearing HMRC confirmed that if E.ON won its appeal, they would remain bound by their undertaking in relation to the final salary scheme members.

### **The submissions, and the outcome of the appeal**

9. On behalf of E.ON, Mr Maugham made the following submissions, all in the alternative:

(1) the Facilitation Payment was compensation for the loss of pension rights, and *Tilley v Wales* [1943] AC 386 (“*Tilley*”) provides binding authority that such a payment is not “from” the employment; and/or

(2) under the replacement principle as described by Lord Woolf in *Mairs v Haughey* [1994] 1 AC 303 (“*Mairs*”), the Facilitation Payment replaced a non-taxable sum, being:

(a) the more generous pension payments that Mr Brotherhood would otherwise have received from the retirement balance scheme;

(b) the higher pension contributions which would have been made by E.ON to Mr Brotherhood’s pension pot; or

(c) the earnings Mr Brotherhood would need, to make the extra pension contributions necessary to obtain the same level of benefits; and/or

(3) the Facilitation Payment was not “from” the employment, because it was “from” something else, namely a reduction in the employees’ pension rights.

10. On behalf of HMRC, Mr Bradley made the following submissions:

(1) *Tilley* did not apply, because the payment in that case was made in exchange for the surrender of a fixed and vested pension right. That was not the position here, because the employees retained all the pension entitlements they had previously accrued, so there was no change to their vested rights.

(2) He noted that Chadwick LJ in *EMI Group Electronics Ltd v Coldicott* [2000] 1 WLR 540 at 556E (“*EMI v Coldicott*”) had correctly observed that it was “not ‘necessarily helpful to press the ‘replacement’ principle too far in this field, where fine distinctions abound”. However, in so far as that principle was a useful guide, he submitted that:

(a) the Facilitation Payment did not replace either more generous future payments from the pension pot, or E.ON’s higher pension contributions, for the reasons explained at §113ff and §121ff; instead

(b) the better analysis is that the Facilitation Payment replaced earnings. As such it was taxable and subject to NICs in the hands of the employees. If an employee subsequently chose to use the Facilitation Payment to make pension contributions, he would receive relief on those contributions. But unless and until he did so, the Facilitation Payment was simply earnings.

(3) The Facilitation Payment was “from” the employment because it was made in exchange for employees agreeing to change their future conditions of employment.

11. I agreed with those submissions. Moreover, as is clear from the findings of fact, the Facilitation Payment did not stand alone, but was part of an “integrated proposal” governing the future employment relationship between E.ON and its employees. This had been negotiated as between E.ON and the Unions, and included not only the Facilitation Payment but also pay increases for all employees, E.ON’s agreement not to close the final salary and

retirement balance schemes and various “employment commitments”. It is not a realistic view of the facts to separate the Facilitation Payment from the rest of that integrated package.

## **EVIDENCE**

12. The Tribunal was provided with a Bundle of documents prepared by the Appellant which included the following:

- (1) the “Guide to the E.ON retirement balance Plan”, dated March 2005;
- (2) joint communications from E.ON and the GMB, Prospect, UNISON and Unite (together, “the Unions”) about proposals for change;
- (3) a Memorandum of Understanding between E.ON and the Unions signed on 23 March 2018 (“the MoU”) and an Umbrella Collective Agreement between the same parties dated 29 October 2018 (“the Collective Agreement”);
- (4) pro-forma letters from E.ON to members of the retirement balance scheme about the proposed changes, and specific letters from E.ON to Mr Brotherhood;
- (5) the joint statement from E.ON and the Unions dated 17 October 2018 as to the completion of the ballot, and the related letter to employees dated 31 October 2018;
- (6) the Member Booklet explaining the changes made, dated 1 July 2020; and
- (7) correspondence between HMRC and E.ON.

13. Mr Christopher Osborne, Head of Pensions at E.ON since 2018, and previously its Pensions Policy Manager, provided a witness statement, gave oral evidence led by Mr Maugham, was cross-examined by Mr Bradley and answered questions from the Tribunal. I found him to be a wholly honest and credible witness. I have however disregarded those parts of his witness statement which set out his view of the law.

## **FINDINGS OF FACT**

14. On the basis of the evidence summarised above, I make the findings of fact set out in the next part of this decision. I have set out the steps which led up to the changes in some detail, as these then form the basis for further findings at §75 to §88.

15. There were certain minor variants to the arrangements which applied to various sub-categories of employee, such as those who were “Metering members” and those who were not in a Union, but neither party submitted that these were relevant to the issue in dispute and I have not taken them into account in making my findings.

### **E.ON and its pension arrangements**

16. E.ON is one of the UK’s leading power and gas suppliers. Since 2008, new employees have been eligible to join a defined contribution (“DC”) scheme called the E.ON Pension Plan. Before that date, employees had been invited to join a retirement balance arrangement, and earlier still employees had been enrolled in a traditional final salary scheme. The retirement balance and final salary arrangements were regarded by E.ON as separate “categories” of membership of the same defined benefit (“DB”) scheme. In mid-2018, approximately 1,400 employees were members of the final salary category; 1,100 were members of the retirement balance category and the DC scheme had around 6,500 members.

### **How the retirement balance category worked before the changes**

17. Before the changes with which this appeal is concerned, the retirement balance category worked as follows:

(1) Each member could select one of five benefit levels, being 20%, 25%, 30%, 35% and 40%, and could change the benefit level in April each year. For example, if a member selected the 30% benefit level, 30% of their pensionable pay in that year was credited as a notional sum to their retirement balance account, and the same was true for other benefit levels.

(2) The retirement balance account was funded partly by the employee and partly by E.ON. The amount contributed by the employee increased with age. Using the same example, a 40 year old employee who had selected the 30% benefit level, would contribute 6.3% of pensionable pay, with E.ON making up the balance of the pension promise as calculated by the Scheme Actuary, including underwriting any investment risk. The following April his contribution would increase slightly to reflect the fact that he was one year older.

(3) A member who had selected the 40% benefit level could purchase additional benefit levels in multiples of 5%, up to a maximum of a 100%. For example, the 40 year old employee would be required to contribute 2.25% of pensionable pay for each 5% of benefit, and the Company would fund the cost of the balance, including underwriting any investment risk. The number of employees taking advantage of this option was low: Mr Osborne's evidence was that, when the changes were implemented in April 2018, there were 75 such employees, or around 7% of the total. Mr Brotherhood was not one of those employees.

(4) Each member's retirement balance account received an inflation linked increase each year in line with the Retail Prices Index ("RPI"), but the Company had the discretion under the Scheme Rules to select a different level of increase.

(5) Members could access the retirement balance amount on retirement in order to take a cash lump sum and/or to purchase a pension from a commercial provider.

### **The starting point**

18. In May 2017, E.ON's management began reviewing the Company's pension arrangements. with the objective of reducing the costs and risks associated with the DB Pension Scheme. They recognised that the legal position was complex, and that to succeed in making changes, the support of the Unions was required.

### **The meetings with the Unions**

19. E.ON held a meeting with the Unions on 5 and 6 July 2017, after which the Unions reported back to their members as follows:

“At the meeting the company presented its opening offer which the trade unions unanimously rejected. Although the joint trade union side acknowledged that E.ON was facing significant challenges it made it clear that any potential resolution had to be balanced, proportionate and affordable.

The joint trade unions also asked for any threat of closure of the existing defined benefit schemes to be removed while negotiations are ongoing. Without this commitment the unions made it clear negotiations could not progress further. The business acknowledged this and agreed to take this position away for consideration and to report back at the next meeting.”

20. A further meeting was held on 25 and 26 July 2017, after which union members were told:

“For any deal to be acceptable, the joint unions have made it clear to the business, that it must be: affordable, proportionate, protects the lowest paid, improves participation, values the rights of protected persons, recognises that pensions are deferred pay and finally, that all workers deserve a decent pension on retirement.”

21. Another update was provided in February 2018, which reiterated the passage set out above, and also included the following:

“While progress on a possible pension settlement has (we consider) been made, we have been clear that a positive outcome also depends on the company being clear and upfront about its employment plans into the future for all staff. The company did produce a series of plans and the trade unions have intervened to amend these to limit future job losses and outsourcing where possible. We will continue to discuss these future employment commitments that we are asking should last into 2021 and seek to agree them along with the other proposals.”

22. Part of those discussions involved the amount of the Facilitation Payment. Mr Osborne’s witness statement said that that “E.ON initially proposed a payment of 5% of salary, the Union negotiators proposed 10% and, after some to-ing and fro-ing the parties agreed at 7.5%”.

#### *The March 2018 Update*

23. On 9 March 2018, a joint “Company and Trade Union update” was issued. This began:

“In May last year, the Company informed the Trade Unions of a review of its current pension arrangements and we’re pleased to let you know that we’ve completed an important step of reaching joint agreement in principle to a package of change that will be consulted on.

The integrated proposal - which was presented to a meeting of all the representatives of all four recognised Trade Unions on 8 March 2018 in Birmingham, and has now received the full endorsement of the Trade Unions - comprises of pensions changes, a set of employment commitments and a 2 year pay deal for our collective population.

The Trade Unions have challenged hard throughout our lengthy and complex negotiations. We’ve been able to find a way through this and come up with a solution that supports the sustainability of our pension schemes and benefits, and positions our employment security and pay offer in the right way for both the business and colleagues - it’s essential to get this right for all of us.

These proposals are an important building block to the future sustainability of E.ON’s UK business.”

24. Under the heading “Pensions” the document continued by saying:

“The focus of the review has been on the Defined Benefit Scheme, which you may also know as the ESPS Final Salary and Retirement Balance Plan. We’re pleased to be proposing to keep the Scheme open but we’re looking to make some modifications to how benefits build up in the future that we believe limits the impact on members and maximises the sustainability of the Scheme.

We’re also proposing to make some improvements for colleagues on the lowest benefit levels in our Defined Contribution Plan, which you may also know as the E.ON Pension Plan.

We're committed to not changing our pensions arrangements for a 5-year period, subject to any extraordinary circumstances.

Subject to securing agreement to the pensions changes, a facilitation payment of 7.5% of salary for all Defined Benefit members is proposed..."

25. The next heading was "Employment Commitments", and the text read:

"As part of the integrated proposal and subject to securing agreement to the pensions changes, we've also jointly agreed a set of employment commitments that will remain in place until 31 March 2021, these are:

- Direct employment of majority of permanent workforce.
- No further outsourcing of existing jobs beyond those previously announced in Residential and IT.
- Current severance scheme (SVS) will remain in place.
- Commitment to the Employment Security Policy...

We fully appreciate that many areas of the business continue to face organisational change and these commitments will, as far as possible, safeguard current and future employment."

26. The following passage was headed "2 year pay deal", and it read:

"As part of the integrated proposal and subject to securing agreement to the pensions changes, there'll be a 2 year pay deal for all colleagues on collective agreements across all areas. The pay award comprises of:

- 3.5% for 2018.
- 3% for 2019 (or average Consumer Price Index between December 2018 and February 2019 – whichever is greater)."

27. Under cross-examination Mr Osborne said that "both sides worked together to achieve something that struck a balance and which was packaged as a complete deal". He added that there was "no specific focus on the Facilitation Payment" but the purpose of the discussions was instead for E.ON and the Unions "to present this as a package of change to members and employees...not just the Facilitation Payment. It was a complete package". When pressed, he said he "wouldn't isolate the Facilitation Payment".

### **The MoU**

28. On 23 March 2018, E.ON and the Unions signed the MoU. This began by saying that it "summarises our agreement on implementation of various changes to the Company's pension schemes along with associated facilitation measures for colleagues impacted by these changes", and continued:

"This MoU also sets out a series of employment commitments and a general pay review effective from 1 April 2018 and 1 April 2019, applicable to all collective agreements currently in operation in the above named companies across all bargaining units, both of which are contingent on acceptance of the pension changes set out below."

29. Although the MoU was not legally binding, the parties agreed to "collaborate in good faith and...seek to enter into the necessary legal documentation to implement this MoU in a timely manner", and stated that the MoU would "assist with the drafting of an Umbrella

Collective Agreement that will be executed after and subject to the outcome of a statutory consultation exercise with employees and a Trade Union ballot result”.

30. It continued by setting out the proposed changes to the final salary category and to the retirement balance category, including the making of the Facilitation Payment and its amount. These passages are the same as those later included in the Company Offer, and are set out below. Under the heading “2018 and 2019 collective pay settlements”, the MoU then said:

“Following successful implementation of the pension changes summarised in section 3 of the MoU, the Company agrees to apply the following pay settlement applicable to all collective agreements in operation across all bargaining units in the above named companies:

(i) With effect from 1 April 2018 all salaries...would be increased by 3.5%.

(ii) With effect from 1 April 2019 all salaries...would be increased by the higher of 3% or the average CPI inflation rate for the period December 2018 to February 2019, subject to the normal rounding rules.

For the avoidance of doubt, members of the E.ON UK Group refusing to consent and contractually agree (in the form the Company determines) to the pension changes in the timeline outlined by the Company would not receive the pay settlement outlined above or any facilitation payments or the DC Accelerator [offered to members of the final salary category] as detailed in sections 4 and 5 of this MoU.”

31. The MoU also set out:

(1) changes to the DC scheme;

(2) a commitment by E.ON to engage in a detailed feasibility exercise “to offer member options from no later than 31 December 2019 that will further enable the managing of funding cost and risk in the pension scheme”;

(3) the setting up of a Pensions Forum made up of representatives from both E.ON and the Unions; and

(4) on condition that the pension changes set out in the MoU were implemented, both parties committed that they would not “seek to make any further changes to pensions for a period of 5 years commencing 1 April 2018”; this was subject only to a force majeure clause.

32. Under the heading “Process” the MoU included this passage:

“Subject to a successful ballot process, a Pensions Umbrella Collective Agreement will be signed by all parties to facilitate the implementation of the pensionable salary increase cap and other changes outlined above including provision to dis-apply any automatic contractual entitlement to pay increases and then only reintroduce such entitlement if an employee first enters into the contractual agreement to introduce validly the cap on future pensionable salary increases described [earlier in the MoU].”

33. Appendix 2 set out a flowchart of next steps in relation to the retirement balance category. It included the statement that if a Scheme member did “sign contractual acceptance”, that person would not receive the pay awards set out above for 2018 or 2019, and would also not receive the Facilitation Payment. The flowchart also states that:



“...it remains possible to implement for this group if more than 50% of all members have contractually agreed – Company position is to request all members complete a form.”

34. In oral evidence, Mr Osborne said that this percentage came from the collective bargaining arrangements with the Unions because a majority was required before the changes could be implemented.

35. Appendix 1 provided a similar flowchart for the final salary category, which stated that if a member did not consent, he would not receive the pay awards or the Facilitation Payment, but (in contrast to the position for the retirement balance members) would also not be bound by the changes to the pension arrangements.

### **The consultation document**

36. In June 2018, E.ON issued all members of the retirement balance category with a consultation document entitled “Securing our pensions future” and a separate consultation document to members of the final salary category. Under the heading “background”, both documents said:

“This is not about taking away benefits that you have already built up (accrued) to date, which you have earned, but like many companies we have to look at how we manage future commitments. In that way we will be better able to fund the pension promises we have already made to you and all of our pensioners.”

37. They also said:

“The pension proposals are part of an integrated package, which has been fully recommended for acceptance by the Trade Unions. This package consists of:

- a proposal for the Scheme to remain open, subject to some changes
- facilitation payments to those affected by the Scheme changes, or the option of additional pension contributions to a separate pension arrangement
- 2018 and 2019 pay awards
- a set of employment commitments
- some improvements for members on the lowest benefit levels of our newer pension scheme, the E.ON Pension Plan, which is a defined contribution pension arrangement.

It is important to note that the offer of pay awards, facilitation payments and employment commitments has been carefully costed against the future changes to the Scheme which are proposed. It is a package. Changing elements will inevitably disturb the balance and is not something that we or the Trade Unions have negotiated towards. We would therefore ask you to look at what is proposed in the round and we are consulting with you on that basis.”

38. It was Mr Osborne’s unchallenged evidence that all of E.ON’s 9,500 UK employees benefited from the pay awards, including those with no interest in the DB Pension Scheme, and that the nature and scale of the awards were comparable with the annual rises typically agreed with the Unions under the group’s collective agreements.

## **The individualised pension statement**

39. Attached to the each copy of the consultation document was an individualised statement showing how the proposed changes affected each member of the retirement balance scheme. The covering letter to these statements included this paragraph:

“The proposed changes to our pension schemes are part of an integrated package that includes pay awards, facilitation payments for those affected by the pension changes and a set of employment commitments, all of which are detailed in this pack. They’re a very important part of our transformation and in securing our future, while avoiding scheme closure as part of this review.”

40. Each scheme member was told that the consultation document “sets out the details of the proposed pension changes that form part of a wider integrated package of change that would allow the Scheme to remain open at this time”. Under the heading “the proposals”, Mr Brotherhood’s statement said:

“The proposed changes apply to the contributions you pay to the scheme and how your retirement balance increases each year in future.

The following changes are proposed:

1. An increase in your member contributions (unless you have selected, and remain on, the 20% core benefit level),
2. The removal of the ability to build up additional benefit levels above the core benefit level of 40% and the introduction of a new Additional Voluntary Contribution (AVC) facility, and
3. A change in the level of inflation used to increase your retirement balance each year.”

41. Each of those proposed changes was then discussed in more detail, as summarised below.

### *Increase in core benefit level*

42. The statement explained that if the employee’s core benefit level was 20%, there would be no change to his contribution; if his core benefit level was 25%, a 1% increase would be required; if it was 30%, the increase would be 2%; if it was 35%, the increase would be 3% and if it was 40%, the increase would be 4%.

43. As Mr Brotherhood had a core benefit level of 40%, the individualised statement went on to explain the effect of those changes as follows:

“Based on your pensionable pay of £47,916 and core benefit level of 40%:

We would credit £19,166 to your retirement balance for the year. You currently pay 8.4% of your pensionable pay towards this: £ 4,025 each year.

Under the current benefit structure, contributions increase as you age (up to age 64), and next year contributions would have been 8.7% of your pensionable pay: £4,169 each year.

Under the proposals, you would pay an additional 4% of contributions, so total contributions of 12.7% of your pensionable pay: £6,085 each year.

This is an increase of £1,917 for the year.

As you receive relief from tax and national insurance contributions, based on current tax rates and your earnings, we calculate that the real cost to you of

this increase is more like £1,303 for the year or £109 per month. So the actual cost is much lower (unless you are currently not paying tax).

As part of the package of change under the proposals, you will also have received a pay award of 3.5% and Facilitation Payment to help mitigate any impact, details of which are shown below. In addition, you could further mitigate any increase by selecting a lower core benefit level, in which case you would pay lower contributions but your retirement balance would build up more slowly.”

44. I note in passing that there is in fact no NICs relief on employee contributions to a pension scheme, but only tax relief, but I have not sought to recalculate the numbers here provided.

#### *Cessation of the option to build up additional benefit levels*

45. The statement then explained that E.ON was proposing to withdraw the option to build up higher benefit levels by making further contributions, and that instead Mr Brotherhood would be able to pay AVCs.

#### *Impact of changing future annual increase*

46. Under this heading, the statement said that the inflation adjustment would in the future be based on CPI not RPI, and that E.ON was able to make this change under the scheme rules. As a result “this change has not been negotiated with the Trades Unions, but we are still required to consult you on it”.

#### *The Facilitation Payment*

47. The second part of the statement was headed “the Facilitation Payment” and began:

“We recognise that the decision to propose changes to your pension benefits will cause uncertainty. This has been a difficult decision, and to recognise the fact, we will offer all members a lump sum payment (“the Facilitation Payment”). In your case, based on our current payroll records, we have estimated this to be a payment of £3,791.”

48. Under the subheading “integrated package of change”, the statement said:

“the figures in this individual statement are specific to you and allow for the proposed pay awards for 2018 and 2019 of 3.5% and 3% respectively...The proposals are part of a package of change including these pay awards, the Facilitation Payment and the employment commitments.”

#### **The Company Offer and the ballot**

49. In September 2018, members of the retirement balance category received:

- (1) ballot information if they were Union members, including a ballot paper to vote on the integrated package of proposals; and
- (2) an offer letter from E.ON, together with a covering letter.

#### *The covering letter*

50. The covering letter was headed “Company Offer to you as a member of the Retirement Balance category of the E.ON UK Group of the Electricity Supply Pension Scheme”, and it began:

“This letter and its attachments are about your pension and pay...They contain an offer (the ‘Company Offer’) to you as a member of the Retirement Balance category of the E.ON UK Group of the Electricity Supply Pension Scheme (the ‘Scheme’).”

51. It continued:

“As you will be aware, the Company announced a review of its pension arrangements in May 2017 and following a detailed process with our Trades Unions (GMB, Prospect, Unison and Unite), we jointly announced an integrated package of proposals aimed at making the Company and the Scheme more sustainable, whilst allowing the Scheme to remain open to allow you to build up further valuable benefits.

The Company Offer is as follows:

1. You are being asked to agree to certain changes to your pension arrangements as outlined in the enclosed agreement (the ‘Offer Letter’). These changes increase the rate of your contributions unless you are on the base benefit level and the basis on which you can make additional voluntary contributions. The Company has already confirmed how it intends to exercise its discretion to apply an inflation linked increase to your retirement balance account in future years.
2. In return for these changes, you are being offered a pay award of 3.5% for the period from 1 April 2018 to 31 March 2019 and a minimum pay award of 3% for the period from 1 April 2019 to 31 March 2020 (the ‘Pay Proposal’).
3. In addition, you are being offered (again in return for these changes) a cash lump sum payment of 7.5% of your basic annual salary as at 1 April 2018 (the ‘Facilitation Payment’) which you can elect to receive as cash or deposit into the Group Additional Voluntary Contribution (AVC) pension facility.

You will have already had the opportunity to attend formal briefings on the proposals to allow you to ask questions. In addition, at the start of the consultation process in June of this year you will have received a document explaining the proposals in full and the Company’s supporting rationale for change, including an individual personal statement to allow you to understand the potential impact. We hope you now feel equipped to consider the Company Offer that is being made to you.

If the proposals are implemented in full, E.ON UK plc has committed, for a period of 5 years from 1 April 2018, not to make any further changes to the Scheme relating to contributions or benefits so far as this is compatible with law, and not to exercise its discretions under the Scheme differently to how they have been exercised in the two years prior to 1 April 2018. This commitment ceases to apply in certain limited circumstances specified in the Umbrella Collective Agreement to be entered into between the Company and the Trades Unions.

You have a choice - you do not have to accept the Company Offer. It is important that you understand that if you do not accept the Company Offer, you will not receive the Pay Proposal outlined above (or any other increases to your current salary or associated allowances) or the Facilitation Payment.”

52. The letter went on to specify that responses were required by 5 October 2018, and that:

“If you do not accept the Company Offer (either electronically on-line or by post) choosing Option A by the above deadline then you will be treated as having rejected the Company Offer.

If you choose to accept the Company Offer, this will be a contractual agreement on the terms contained in the Offer Letter and the Acceptance Form.

The Group Trustee of the Scheme, E.ON UK Trustees Limited, has reviewed the Company Offer comprised in the Offer Letter and the Acceptance Form. If you choose Option A, the Group Trustee has confirmed that it will administer the Scheme on the basis of your agreement.

If you do not agree to the proposed changes, they will not be prevented from going ahead if the majority of members support them. In addition, in such a situation, you would (as explained above) also not receive the Pay Proposal or the Facilitation Payment.”

### *The Company Offer*

53. The Offer Letter began with this passage, in bold type:

“The terms of this Offer Letter are intended to give rise to a legally binding contract. You should read this document carefully and confirm your decision by completing the enclosed Acceptance Form. You should then sign and date the form.”

54. Under the heading “What is the Company Offer to you?”, the text read:

“This is an integrated offer and consists of the following:

1. The Company is offering a 2 year pay deal (the ‘Pay Proposal’).
2. A cash lump sum payment of 7.5% of your pensionable pay as at 1 April 2018 (‘the Facilitation Payment’) which you can elect to receive as cash or deposit into the Group Additional Voluntary Contribution (AVC) pension facility).

Further details on the Company Offer are as follows.

#### The Pay Proposal

For the period 1 April 2018 to 31 March 2019, the Company is offering you a 3.5% increase to your current basic annual salary

For the period 1 April 2019 to 31 March 2020, the Company is offering you an increase to your basic annual salary at 1 April 2019 equal to the higher of 3% or the average change in the Consumer Prices Index over the three-month period December 2018 to February 2019...

#### The Facilitation Payment

The Company is offering a cash lump sum payment of 7.5% of your pensionable pay as at 1 April 2018, following application of the first part of the Pay Proposal outlined above. This is subject to a minimum payment of £1,000...

You can elect to receive this payment as cash or deposit it into the Group Additional Voluntary Contribution (AVC) pension facility with Standard Life...”

55. Under the heading “What are the terms of the Company Offer?” the text read:

“There are two changes that we would like you to agree to, with regards to your benefits from the Scheme. Your acceptance of the Company Offer is conditional upon your agreement to these two changes:

1. An increase in the rate of your contributions, described in more detail in paragraph (a) below, unless you are on the base benefit level or elect to move to this benefit level (in which case there is no increase).
2. A change to the basis on which you can make additional voluntary contributions in future, described in more detail in paragraphs (b) and (c) below.

In addition, the Company has already confirmed how it intends to exercise its discretion under the Rules to apply an inflation linked increase to your Retirement Balance account in future years.”

56. As noted above, paragraph (a) provided more detail about the proposed new contribution rates, and read:

“With effect on and from 1 April 2019, the employee contribution rates will be increased as follows:

- For members on the 20% Core Benefit Level (referred to as the base benefit level above), there will be no increase to the employee contribution rate across all of the age ranges.
- For members on the 25% Core Benefit Level, there will be a one percentage point increase to the contribution rate across all of the age ranges.
- For members on the 30% Core Benefit Level, there will be a two percentage point increase to the contribution rate across all of the age ranges.
- For members on the 35% Core Benefit Level, there will be a three percentage point increase to the contribution rate across all of the age ranges.
- For members on the 40% Core Benefit Level, there will be a four percentage point increase to the contribution rate across all of the age ranges.

You will have the option to select your Core Benefit Level (and therefore contribution level) for the 2019/20 year in the normal way via the flexible benefits system, My Choice, when the system opens early next year. This will allow you to select a lower Core Benefit Level to mitigate the contribution increases if you wish.”

57. This was followed at (b) and (c) by further detail about the proposed AVC changes:

“The rules of the Scheme will be amended such that the existing additional voluntary contribution arrangements that allow members to purchase additional benefit level credits (above the 40% Core Benefit Level) will cease.

As from 1 April 2019, you will instead be able to utilise the same Group Additional Voluntary Contribution (AVC) arrangements that are currently available to the Final Salary category members. These are currently provided by Standard Life on a defined contribution basis. Further details of the facility are available on request.”

58. The next paragraph explained that E.ON had already decided to move from RPI to CPI when valuing the retirement balance account of the members, and that this was not a matter which was part of the consultation.

59. Under the heading “Why is the Company making the Company Offer subject to your contractual agreement on these terms?” the document explained the pension costs burdens on the business and continued:

“The Company would like to be able to continue to offer what it believes is a fair employee/employer contribution structure, and to offer a suitable mechanism for colleagues to make additional voluntary contributions. The Company would prefer to receive your informed consent to these changes via your contractual agreement. The Scheme would then be run in line with your agreement.

The Company has entered into a Memorandum of Understanding with the Trades Unions in which it has committed, subject to certain conditions, not to make further changes to pensions for a period of 5 years from 1 April 2018 as long as the changes currently proposed are implemented. What this means in particular is that for a period of 5 years from 1 April 2018, E.ON UK plc will not:

- (i) amend the provisions of the Scheme relating to contributions or benefits; or
- (ii) exercise discretions conferred on it by the rules of the Scheme (other than those referred to in this Letter) in a manner different to how they have been exercised in the two years prior to 1 April 2018; so far as this is compatible with law. This commitment ceases to apply in certain limited circumstances specified in the Umbrella Collective Agreement to be entered into between the Company and the Trades Unions.”

60. Under the heading “if you wish to reject the Company Offer”, the letter said that if the offer was refused, the employee would not receive the pay rises or the Facilitation Payment. The following page was headed “Acceptance Form”, and reiterated that an employee who rejected the offer understood that he would not receive “the Pay Proposal (or any other increases to my current salary or associated allowances) or the Facilitation Payment”. An employee accepted the offer by ticking the box next to the text below:

“I wish to accept, with my informed consent, contractually and irrevocably (and conditional only upon formal notification being sent by the Company that it will be implementing the arrangements as outlined in the Offer Letter) the Company Offer, both for myself and on behalf of my contingent beneficiaries under the Scheme.”

61. The text continued “In accepting the Company Offer, in addition to the Pay Proposal, I would also like to receive...” followed by options to have the Facilitation Payment paid in cash, or paid into the AVC.

62. Mr Brotherhood received the Offer Letter on 14 September 2018. He accepted the Offer.

### **The outcome of the process**

63. On 17 October 2018, E.ON and the Unions issued a joint update, saying that both the ballot and the responses to the Company Offer had been “overwhelmingly” in favour and that the proposals would be implemented. The update then says that the Facilitation Payment and

the pay rises apply to “all colleagues except those members of the ESPS Final Salary, and Retirement Balance Plan pension schemes who didn’t return their acceptance forms”.

64. Mr Osborne’s unchallenged evidence was that *the ballot* resulted in 100% acceptance of the Company Offer in both Categories of the DB Pension Scheme, with no rejections of the proposals and zero non-responses. It was thus unclear on the evidence whether there were some non-union retirement balance members who did not receive the Facilitation Payment and the pay rises because they had failed to send back their forms.

65. When asked what would have happened had there not been a majority in favour, Mr Osborne said that this was not discussed, but that E.ON would have looked at closing the retirement balance and final salary categories of the DB pension scheme. That evidence too was not challenged.

66. The relevant changes to the Scheme were effected by a Deed of Amendment dated 29 October 2018. On the same date, E.ON and the Unions signed the Collective Agreement. This states, *inter alia*, that receipt of the pay award and the Facilitation Payment were conditional on an employee agreeing to the Company Offer in the form previously set out and as also annexed to the Collective Agreement.

67. The Collective Agreement also contained essentially the same other provisions as had been set out in the MoU, namely changes to the final salary category; changes to the DC scheme; the feasibility analysis, the Pensions Forum and E.ON’s agreement not to make further changes to the pension arrangements for five years. Appendix 2 disapplied automatic contractual entitlement to pay increases for members of the final salary category and made them conditional on the employees agreeing to the relevant Offer Letter. The Tribunal was not provided with a similar Appendix relating to the retirement balance members, but has inferred from the MoU and from the wording of the Offer Letter that the same disapplication was implemented.

68. E.ON paid cash Facilitation Payments totalling around £6.48m to 2,238 pension scheme members through the November 2018 payroll. Tax and NICs were deducted in all cases save that of Mr Brotherhood, pending the outcome of this appeal. In addition, 262 pension scheme members received amounts totalling around £959k which they contributed as AVCs to the group AVC pension facility.

69. Consequential changes to contribution levels were implemented in April 2019, at which date:

- (1) There were 1,016 employees remaining in the retirement balance category.
- (2) Of those, 93 members opted for a lower benefit level and 880 remained on the same benefit level.
- (3) Approximately 600 increased their contributions to achieve the same core benefit outcome.
- (4) A further 75 members who were previously purchasing additional benefit levels lost that option.
- (5) 103 members of the DB Pension Scheme (both Categories together) left E.ON prior to April 2019 but still received the Facilitation Payment, which was not conditional on future service.



## **The assessments and the appeals**

70. E.ON asked HMRC to agree that the Facilitation Payment was not taxable, but despite extensive correspondence, HMRC remained of the view that it was.

71. On 9 November 2018, Mr Colin Frew of HMRC's Large Business Office wrote to Mr Sheppard, E.ON's head of indirect tax, saying that HMRC understood E.ON wanted the competing views "to be tested" and suggesting that one possible route was:

"...to use the NIC regulations (section 8 of the SSC(ToF)A 1999) as a route into the tribunal service. If my understanding of the regulations is correct then we could use a single named employee as a 'test' case to check/challenge the NIC treatment, which has an appeal right to the tribunal service. The decision on this 'test' would then be applied to the body of employees. It covers NIC specifically, but I can see no material difference between the 'earnings' point for NICs and for Income Tax."

72. On 14 November 2018, Mr Sheppard said that "in principle, we are in agreement with the alternative approach you suggest, whereby a single named employee will act as a 'test case' on behalf of the wider population of affected individuals". On that basis, E.ON deducted tax and NICs from all employees other than Mr Brotherhood.

73. On 3 October 2019, in respect of the Facilitation Payment made to Mr Brotherhood, HMRC issued E.ON with:

- (1) a determination of £758 under Reg 80 of the PAYE Regs; and
- (2) a decision under Reg 8 of the SS(ToF)A, charging NICs of £987.07.

74. On 1 November 2019, E.ON appealed the determination and the decision to the Tribunal. On 9 January 2020, the Tribunal directed that the appeals be joined. They were subsequently categorised as complex under Rule 23 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009.

## **Further findings of fact**

75. I make the following further findings on the basis of the detailed facts already set out above.

### *An "integrated proposal"*

76. The Facilitation Payments did not stand alone, but were part of an "integrated proposal" comprising many elements. These had been negotiated as between E.ON and the Unions and could not be amended by any individual employee (see for example §37).

77. The March 2018 Update said the elements of that integrated proposal included:

- (1) a two year pay deal for all employees, not just those in the DB scheme;
- (2) changes to contributions to the retirement balance and the final salary schemes;
- (3) an improvement to the position for employees in the DC scheme;
- (4) the Facilitation Payment for retirement balance and final salary members;
- (5) E.ON's commitment not to make any further changes to pensions for five years;
- (6) a "set of employment commitments" to remain in place till March 2021 which included

- (a) direct employment of the majority of permanent workforce;
- (b) no further outsourcing of existing jobs beyond those previously announced;
- (c) current severance scheme to remain in place; and
- (d) commitment to the Employment Security Policy

78. Mr Osborne said that “both sides worked together to achieve something that struck a balance and which was packaged as a complete deal”; that there was “no specific focus on the Facilitation Payment” but the purpose of the discussions was instead for E.ON and the Unions “to present this as a package of change to members and employees...not just the Facilitation Payment. It was a complete package”. When pressed, he said he “wouldn’t isolate the Facilitation Payment”.

79. The MoU stated that the employment commitments and the pay review were “contingent upon” acceptance of the pension changes.

80. The June 2018 consultation document said (emphases added)

“The **pension proposals are part of an integrated package**, which has been fully recommended for acceptance by the Trade Unions. This package consists of:

- a proposal for the Scheme to remain open, subject to some changes
- facilitation payments to those affected by the Scheme changes, or the option of additional pension contributions to a separate pension arrangement
- 2018 and 2019 pay awards
- a set of employment commitments
- some improvements for members on the lowest benefit levels of our newer pension scheme, the E.ON Pension Plan, which is a defined contribution pension arrangement.

It is important to note that the offer of pay awards, facilitation payments and employment commitments has been carefully costed against the future changes to the Scheme which are proposed. **It is a package. Changing elements will inevitably disturb the balance and is not something that we or the Trade Unions have negotiated towards.** We would therefore ask you to look at what is proposed in the round and we are consulting with you on that basis.”

81. Similarly, the individualised pension statement emphasised the integrated nature of the package and that avoiding scheme closure was part of that package. It said (again, emphasis added):

“the **proposed changes to our pension schemes are part of an integrated package that includes pay awards, facilitation payments for those affected by the pension changes and a set of employment commitments**, all of which are detailed in this pack. They’re a very important part of our transformation and in securing our future, **while avoiding scheme closure as part of this review.**”

82. The same document also said that the proposals being put forward “are part of a package of change including these pay awards, the Facilitation Payment and the employment

commitments”. The covering letter with the Letter of Offer opened by referring to the detailed negotiations with the Unions, which led to “an integrated package of proposals aimed at making the Company and the Scheme more sustainable, whilst allowing the Scheme to remain open to allow you to build up further valuable benefits”.

83. On 29 October 2018, the same date as the scheme rules were changed, E.ON and the Unions signed the Collective Agreement which contained essentially the same provisions as had been set out in the MoU, namely changes to the final salary and retirement balance categories; the pay awards; the Facilitation Payments. the changes to the DC scheme; the feasibility analysis, the Pensions Forum and E.ON’s agreement not to make further changes to the pension arrangements for five years.

#### *The Offer*

84. The Letter of Offer began by stating that it “intended to give rise to a legally binding contract” between E.ON and each retirement balance member. It asked retirement balance members to agree to the following:

- (1) payment of increased employee contributions if the same level of retirement balance was to be maintained;
- (2) acceptance that the employee would no longer be able to purchase additional benefit levels;
- (3) receiving the Facilitation Payment either in cash or as a contribution to an AVC; and
- (4) receipt of the specified salary increase over two years.

85. Although the Offer Letter did not ask the employee to agree to each of the elements in the integrated package, the offer nevertheless formed part of that package and was conditional “upon formal notification being sent by the Company that it will be implementing the arrangements as outlined in the Offer Letter”. The Facilitation Payment was 7.5% of members’ pensionable salary, *after* the first of the two pay rises which also formed part of the package.

86. All union members were balloted on whether to accept the integrated package set out in the MoU, which included the Facilitation Payments and the pension changes. On the basis of Mr Osborne’s unchallenged evidence (see §65) E.ON would have considered closing the DB scheme if the package had been rejected in the ballot: in other words, the pension proposals were part and parcel of the larger deal involving the rest of the workforce and the Unions, and these stood or fell together.

#### *The effect of refusing the offer*

87. The effect on an individual of refusing the offer can be seen from the following:

- (1) The MoU specified that members who refused the offer “would not receive the pay settlement...or any facilitation payments”. It also stated that, subject to a successful ballot, a Collective Agreement would be signed which, *inter alia*, would “dis-apply any automatic contractual entitlement to pay increases and then only reintroduce such entitlement if an employee first enters into the contractual agreement...” Appendix 2 to the MoU included the statement that if a retirement balance member did not agree to the contractual changes proposed, he would not receive the pay awards for 2018 or 2019 or the Facilitation Payment.

(2) The Letter of Offer said “It is important that you understand that if you do not accept the Company Offer, you will not receive the Pay Proposal outlined above (or any other increases to your current salary or associated allowances) or the Facilitation Payment”.

(3) The Collective Agreement amended previous agreements with the Unions in order to implement the relevant changes.

#### *Accrued rights protected*

88. The changes did not affect members’ accrued pension entitlements. This is clear from the structure of the arrangements, which relate only to future contributions. It is emphasised in the June 2018 consultation document, which was entitled “Securing our pensions *future*” (emphasis added) and which explicitly stated:

“This is not about taking away benefits that you have already built up (accrued) to date, which you have earned, but like many companies we have to look at how we manage future commitments.”

### **THE LEGISLATION**

89. ITEPA s 9 reads:

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

(2) In the case of general earnings, the amount charged is the net taxable earnings from an employment in the year.

(3) That amount is calculated under section 11 by reference to any taxable earnings from the employment in the year (see section 10(2)).

...

(6) Accordingly, no amount of employment income is charged to tax under this Part for a particular tax year unless –

(a) in the case of general earnings, they are taxable earnings from an employment in that year.”

90. SSCBA s 3(1) reads:

“In this Part of this Act and Parts II to V below –

‘earnings’ includes any remuneration or profit derived from an employment; and

‘earner’ shall be construed accordingly.”

91. SSCBA s 6 reads:

“Where in any tax week earnings are paid to or for the benefit of an earner over the age of 16 in respect of any one employment of his which is employed earner’s employment –

(a) a primary Class 1 contribution shall be payable in accordance with this section and section 8 below if the amount paid exceeds the current primary threshold (or the prescribed equivalent); and

(b) a secondary Class 1 contribution shall be payable in accordance with this section and section 9 below if the amount paid exceeds the current secondary threshold (or the prescribed equivalent).”

92. It was common ground that there was no difference between the test to be applied for income tax, that earnings are “from” the employment, and that to be applied for NICs, that earnings were “any remuneration or profit derived from an employment”.

### **SUBMISSIONS AND DISCUSSION**

93. The Appellant’s case rested first on *Tilley*; then on the replacement principle as set out in *Mairs*, and finally on the proposition that the Facilitation Payment was not “from” the employment because it was from something else. I have taken these in turn.

#### ***Tilley v Wales***

94. The facts of *Tilley* were set out at the beginning of Viscount Simon’s judgment.

“Three agreements were made at different dates between Stevenson and Howell, Ld., carrying on the business of manufacturing chemists, and the appellant, Vernon James Tilley. The first of these agreements was dated December 19, 1921. It recited that the appellant was ‘the inventor of a secret process for the manufacture of a product to be used by the company in connexion with their manufacturing business.’ Under this agreement, the appellant who was already a director of the company, divulged to the then managing director his secret process, and the company contracted to pay to the appellant a royalty of one shilling on every pound weight of the new product manufactured under the secret process and used by the company.

The next agreement was dated June 28, 1937. By that time the appellant had become managing director and as such was receiving a salary of 2000*l.* per annum. The agreement cancelled the arrangement of 1921 for the payment of the royalty and in consideration of this provided that the appellant’s salary as managing director should be raised to 6000*l.* per annum, and that, in the event of the appellant ‘ceasing from any cause whatsoever to be managing director of the company, the company agrees to pay to him as and from the date of cessation a pension of 4000*l.* per annum for ten years from the same date.’ The agreement ended with a paragraph providing that ‘the expression “Mr. Tilley” includes, where the context so permits, his personal representatives.’

The agreement dated April 6, 1938, recited the provisions made the year before for the salary and pension and then went on to record that the company had requested the appellant (1.) to release it from the prospective obligation to pay the pension, and (2.) to serve the company in future at a salary of 2000*l.* per annum. The agreement witnessed the appellant’s acceptance of these requests, and in consideration of this the company agreed to pay to Mr. Tilley the sum of 40,000*l.* by two equal instalments...”

95. Mr Tilley thus received £40,000 in exchange for:

- (1) agreeing to a reduction in annual pay from the previously agreed £6,000 to £2,000; and
- (2) releasing his employer from its obligation to pay the pension.

96. The statutory framework at the time was that earnings were taxable under the first head of Sch E, and pensions were taxable under the second head of the same Schedule. The Court of Appeal decided that the part of the payment which related to the reduced salary was taxable under the first head of Sch E, and that as a pension would be taxable under the second head, the commutation of a pension was also taxable under Sch E. Mr Tilley appealed to the House of Lords.

97. Viscount Simon, with whom Lords Atkin and Russell concurred, began his judgment by noting that “The circumstances in which this question arises are very special”. He accepted that if the pension had been paid it would have been taxed under the second head of Sch E, but said that “if an individual agrees to exchange his right to a pension for a lump sum, that sum is not taxable under Sch. E” as it is “in the nature of a capital payment which is substituted for a series of recurrent and periodic sums which partake of the nature of income”. Lord Thankerton agreed with Viscount Simon “in so far as the payment of the 40,000*l.* may be referable to the agreement to accept a sum in commutation of the liability to pay a pension”. Lord Porter agreed that the amount was not taxable, saying it was “a sum paid for the release of an obligation to provide a pension” and was:

“neither pension nor annuity and comes under no other heading of that Schedule [E]...but I doubt if much assistance is to be obtained by making use of the antinomy between capital and income.”

98. The case was remitted to the Special Commissioners to decide how much of the £40,000 related to the salary and how much to the commutation of the pension.

*Mr Maugham’s submissions*

99. Mr Maugham said that the facts of this case were “indistinguishable” from those in *Tilley*, as the Facilitation Payment was made “as compensation for the contingent future loss of pension rights”, and he referred to the similar submission he had made before the FTT in *Kuehne*. In that case employees of Scottish & Newcastle UK Limited (“S&N”) had been transferred to Kuehne + Nagel Drinks Logistics Ltd (“KNDL”). The facts were summarised by Judge Hellier at [4] of his judgment:

“The transfer of the business was a relevant transfer for the purpose of the Transfer of Undertakings (Protection of Employment) Regulations 2006, (TUPE). The effect of TUPE was that, with certain exceptions, the 2,000 transferring employees of the distribution business would acquire rights against KNDL which were the same as those they had before the transfer against S&N. One of those exceptions was in relation to the future accrual of pension rights. During the consultations with the union and others prior to the transfer it became apparent that the employees were seriously concerned because they considered that the KNDL pension scheme was not as generous as the S&N scheme. Industrial action was considered. Eventually it was agreed that payments of £3,000 (immediately) and £2,000 (a year later) would be made to the transferring employees.”

100. At [44] Judge Hellier said:

“Once the business was transferred to KNDL the employees had little choice: their contracts of employment were automatically transferred to KNDL unless they objected. But if they objected their employment terminated without compensatory rights. So generally they had to transfer. On transfer they kept almost all their previously accrued rights apart from their rights to accrue extra pension under the S&N scheme.”

101. In *Kuehne* Mr Maugham sought to rely on *Tilley*, and Judge Hellier said (emphasis added):

“[86]...a sum paid simply and solely to recognise the removal of a voluntary pension **or the removal of an expectation of a pension** should be treated in the same way as a sum paid solely in exchange for a vested pension right and therefore not be treated as from employment.

[87] I can see no basis for distinguishing the reasoning of *Tilley v Wales* if the lump sum in this case could be said to have been paid simply and solely for the loss of the pension rights and not for something else as well.

[88] But in this appeal it seems to me that the payments were not just made for the loss of expectation. They were not simple *ex gratia* payments reflecting the fact that something had been taken away. Instead they were payments also made to secure the future good service of the employees.

102. In Mr Maugham’s submission, the FPN was made “simply and solely to recognise...the removal of an expectation of a pension” and, in line with Judge Hellier’s analysis, *Tilley* applied to the facts of this case, and as House of Lords decision, was binding on this Tribunal.

#### *Mr Bradley’s submissions*

103. Mr Bradley submitted that the facts of *Tilley* were distinguishable from those in this appeal. In *Tilley* Stevenson and Howell had made a payment to buy out fixed vested rights held by the employee, whereas here the payment was part of a package which *inter alia* changed the employee’s future rights to pension accrual. The recipients did not lose any part of the entitlements they had already built up within their retirement balance. Mr Bradley therefore did not agree with Judge Hellier that the *ratio* of *Tilley* extended to a payment for “the removal of an expectation of a pension”.

#### *Discussion*

104. It is important to begin with the facts of *Tilley*:

(1) Mr Tilley had originally contracted with Stevenson and Howell that, in exchange for providing the company with a secret process he had invented, he would receive a royalty of one shilling per pound weight of the new product manufactured under that process which was used by the company.

(2) In 1937, in consideration for the cancellation of that agreement, Mr Tilley received a fixed salary, plus the right to be paid a pension of £4000 per annum for ten years from the date he ceased to be managing director.

(3) The following year that agreement was changed. Mr Tilley released the company “from the prospective obligation to pay the pension” and accepted a lower salary, in exchange for £40,000.

105. Mr Tilley therefore received part of the £40,000 in exchange for giving up an existing vested right to a pension. The case thus concerned a situation where, as Viscount Simon said, a person “agrees to exchange **his right to a pension** for a lump sum, or as Lords Thankerton and Porter put it, where there is an “agreement to accept a sum in commutation of **the liability** to pay a pension” and “a sum [is] paid for the release of **an obligation to provide a pension**” (emphases added). I agree with Mr Bradley that the *ratio* of *Tilley* does not extend to an expectation of a future pension.

106. As he said, the position here is not on all fours with *Tilley*. The Facilitation Payments were not given to compensate employees for the loss of any part of the entitlements they had already built up within their retirement balance. Those accrued entitlements were unaffected by the change, see §88. Scheme members who left employment after receiving the Facilitation Payment but before April 2019 when the new pension arrangements came into effect, retained both the Facilitation Payment and their accrued entitlements, see §69(5).

107. It follows from the above that I respectfully disagree with Judge Hellier’s statement that “the removal of an expectation of a pension” is part of the *ratio* of *Tilley*. However, as his judgment in *Kuehne* was appealed to the UT and then to the Court of Appeal, I considered whether I was bound by the judgments of those higher courts. However, as Mr Bradley pointed out, both parties had approached those appeals on the basis that there were two reasons for the payments to employees by KNDL: a taxable reason (to avoid disruption and possible strike action) and a non-taxable reason (the change to future pension entitlements). Judge Hellier’s finding as to the non-taxability of the pension element was therefore not in issue before either the UT or the Court of Appeal, and it follows this Tribunal is not bound by that finding.

### ***Mairs v Haughey***

108. The only judgment in *Mairs* was given by Lord Woolf, with whom the other Law Lords agreed. The facts are as follows:

(1) Mr Haughey was employed by the shipyard Harland and Wolf (“H&W1”). In 1989 a new corporate structure was proposed, which would allow H&W1 to be privatised. The first stage of the restructuring was that a sufficient number of the employees whom management wished to retain had to agree a transfer from H&W1 to a new company, called H&W3, on new terms and conditions of employment.

(2) Under their conditions of employment with H&W1, Mr Haughey and other employees had attractive contingent rights in a non-statutory enhanced redundancy scheme. After extensive discussions it was eventually agreed that those who accepted the offer of employment with the new company on the proposed terms would receive an *ex gratia* payment consisting of two elements:

(a) Element A, being 30% of the amount of the enhanced redundancy payment to which they would have been entitled had they been made redundant; and

(b) Element B, being £100 for each completed year of service, subject to a minimum of £700.

(3) Mr Haughey agreed to join the new company and accordingly received an *ex gratia* payment of £5,806, comprising £4,506 under element A and £1,300 under B. The issue before the House of Lords was whether element A was taxable under Sch E as an emolument.

109. It was common ground that the *ratio* of the case was set out by Lord Woolf at [40]:

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

### ***Application to this case***

110. Mr Maugham relied on the principle summarised above. He made three submissions, all in the alternative. His skeleton argument said that the Facilitation Payment:

(1) replaced the more generous payments that Mr Brotherhood and his colleagues would otherwise have received from the retirement balance scheme, and so were not “from” the employment but instead from his “pension pot”; or



(2) replaced the higher pension contributions which would have been made by E.ON to the pension pots of the retirement balance members, and such contributions are not taxable earnings.

111. During the hearing, Mr Maugham made the further submission that the Facilitation Payment replaced the earnings which the member would require in order make the higher pension contributions.

112. I set out each of Mr Maugham's alternatives below, albeit in a different order, together with Mr Bradley's responses and my views.

*Replacement for more generous payments from the retirement balance scheme?*

113. The first submission was that the Facilitation Payment replaced "the more generous payments that Mr Brotherhood and his colleagues would otherwise have received from the retirement balance scheme" and so were from the "pension pot" and not from his employment.

114. Mr Bradley submitted that it was clear on the facts that this was incorrect. Mr Brotherhood had the right to the same pension benefits both before and after the change; the difference was that he was required to make a higher contribution for the same benefits.

115. I agree with Mr Bradley. The result of the change was that Mr Brotherhood could receive exactly the same retirement benefits: what had changed was the ratio of employer and employee contributions to the pot from which the benefits were paid. It is therefore not factually correct to say that the Facilitation Payment was compensation for a change to the retirement pension which would eventually be paid to him.

116. The only element of the package which had been removed entirely was the option to purchase additional benefit levels in multiples of 5%, up to a maximum of 100%, and I return to this at the end of this decision.

*Replacement salary to allow employee to make pension contributions?*

117. Mr Maugham submitted during the hearing that the Facilitation Payment increased the member's earnings so that he could make the higher pension contributions required to obtain the same level of benefit. Since pension contributions made out of earnings are not taxable, the same treatment should apply to the Facilitation Payment.

118. Mr Bradley accepted that the effect of the changes was that:

- (1) in order to maintain the same benefit level, the employee had to make higher pension contributions;
- (2) his take home pay reduced as a result; and
- (3) it followed that the Facilitation Payment could be seen as replacing lost earnings.

119. However, in Mr Bradley's submission, it did not follow from that analysis that the Facilitation Payment was not taxable. Instead, on receipt by the member, the Facilitation Payment was earnings, and as such taxable and subject to NICs in his hands. If the employee subsequently used the Facilitation Payment to make pension contributions, he would obtain tax relief at that point.

120. Again, I agree with Mr Bradley. There are two steps here: the first is that the Facilitation Payment could be characterised as replacing the employee's earnings. If, as a second step, the employee decides to use his earnings to make higher contributions to his retirement balance, he will obtain tax relief at that point. But he had a choice: he could instead reduce his pension contributions and retain the whole of the Facilitation Payment.

*Replacement for pension contributions which E.ON would have made?*

121. Mr Maugham also submitted that the Facilitation Payment could be characterised as replacing the pension contribution which E.ON would otherwise have made to the pension pot. As pension contributions made by an employer are not normally taxable on the employee, it followed in his submission that the Facilitation Payment was also not taxable.

122. Mr Bradley said that Mr Maugham's characterisation of the Facilitation Payment as replacing E.ON's contributions to the pension pot was "at best, a stilted approach to the facts" and exemplified the sort of approach to which the dictum of Chadwick LJ applied when he said in *EMI v Coldicott* that it was "not 'necessarily helpful to press the 'replacement' principle too far in this field, where fine distinctions abound". In Mr Bradley's submission the reality was that:

- (1) the employee's only right under the scheme was that the amount in his retirement balance account would be used to pay a lump sum on retirement, and/or a pension, and
- (2) E.ON's only obligation was to make such contributions into the scheme as the scheme actuary calculated to be necessary to underwrite the prospective provision of benefits to members, but the greater or lesser amount of such contributions did not affect the employee's rights as such.

123. As I have already found, the better characterisation of the Facilitation Payment under the replacement principle, and the one which is most consistent with the facts, is that it was paid to replace the shortfall in earnings which members would experience if they wanted to maintain the same pension benefits. I agree with Mr Bradley that, given the nature and operation of retirement balance schemes, it is inapposite to characterise the Facilitation Payment as replacing a future payment by the employer.

*Conclusion on the replacement principle*

124. Of the three options put forward by Mr Maugham, the one which can best be reconciled with the facts is that the Facilitation Payment replaced the lower earnings which the employees would suffer if they wanted to maintain the same level of benefits. Under that characterisation, the Facilitation Payment replaced earnings, and is taxable as such and subject to NICs.

**What was the Facilitation Payment from?**

125. Mr Maugham's third submission concerned the fundamental question as to what the Facilitation Payment was "from". In *Laidler v. Perry* (1966) 42 TC 351, Lord Reid said at 363:

"There is a wealth of authority on this matter, and various glosses on or paraphrases of the words in the Act appear in judicial opinions, including speeches in this House. No doubt they were helpful in the circumstances of the case in which they were used, but in the end 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."

### *Mr Maugham's submissions*

126. Mr Maugham relied on *Shilton v Wilmshurst* [1991] 1 AC 684, where Lord Templeman had said at 689:

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

127. In Mr Maugham’s submission, it was clear on the facts that the Facilitation Payment was not a reward for past services, because it was paid irrespective of the length of time an employee had been with E.ON. It was also not a reward for future services, because it was payable whether or not the employee continued to work for E.ON after receipt. Instead, it was paid for “something else”, namely a reduction in the employee’s pension rights.

### *Mr Bradley's submissions*

128. Mr Bradley said that the Facilitation Payment was paid for the employee agreeing to change his conditions of employment for the future, and so was *prima facie* from employment. In exchange for the Facilitation Payment the employee agreed to new contractual terms which required him to make higher pension contributions to maintain the same level of future retirement balance, and he also agreed to the removal of his ability to purchase additional benefit levels, and those terms came into effect in April 2019.

129. The Facilitation Payment was thus compensation for a change to the conditions of employment going forwards, and this was a change to which all employees and the Unions had agreed. The fact that individual employees left before the change to the pension rules was implemented did not change that analysis.

### *Discussion and conclusion*

130. Again, I agree with Mr Bradley. The Facilitation Payment was, to use Lord Templeman’s phrase “an inducement to...provide future services” on different terms. In other words, in exchange for the employees in the retirement balance scheme agreeing to a change to their future conditions of employment. It was thus “from” the employment within the normal meaning of that term.

131. Moreover, as is clear from my findings of fact, see in particular §76 to §87, the Facilitation Payment did not stand alone, but was part of an “integrated package”. This had been negotiated and agreed between E.ON and the Unions, and was subsequently agreed with union members and the members of the pension schemes. The package included not only the Facilitation Payments and the changes to future contributions, but also a two year pay deal for all employees, a commitment by E.ON not to make further amendments to the pension arrangements for five years, and a set of “employment commitments”, which remained in place for two years.

132. The package changed the future relationship between E.ON and the employees, and the payments made under and as a result of that package were clearly “from” the employment.

The Facilitation Payment cannot be separated out from the rest of that integrated package. I note that this finding is entirely consistent with Mr Osborne’s own evidence, see §27, that there was “no specific focus on the Facilitation Payment”; instead, the changes were “a complete package” and he “wouldn’t isolate the Facilitation Payment”.

*The removal of the option*

133. As noted above, the option to purchase additional benefit levels was the only element of the original pension arrangements which was entirely removed by the changes. Mr Brotherhood had not taken up that option, and it was used by only 7% of scheme members.

134. It is clear from the Court of Appeal’s decision in *Kuehne* that a payment is “from” the employment if employment is a “substantial cause” of the payment. I have concluded for the reasons set out above that Facilitation Payment was “from” the employment, and that conclusion encompasses the removal of this option as well as the other elements of the package.

**CONCLUSION AND APPEAL RIGHTS**

135. For the reasons set out above, I refuse E.ON’s appeals against HMRC’s determination of £758 under Reg 80 of the PAYE Regs, and against HMRC’s decision under Reg 8 of the SS (ToF) Act, charging £987.07 of NICs, both in respect of Mr Brotherhood’s Facilitation Payment.

**Right to apply for permission to appeal**

136. 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.

**ANNE REDSTON  
TRIBUNAL JUDGE**

**RELEASE DATE: 15 MAY 2021**