# TC01999

**Appeal number: TC/2010/09266**

***INCOME TAX – payment in consequence of the termination of contract of employment – whether within Ch.3, Pt. 6, ITEPA and subject to exemption from tax for the first £30,000 under s.403 ITEPA, or 'earnings' within s. 62, ITEPA – contractual provision in the contract of employment for payment in lieu of notice – whether payment made pursuant to that provision or alternatively for settling disputes arising in relation to its application – held the source of the payment was the contractual provision in the contract of employment for payment in lieu of notice and the payment was therefore 'earnings' within s.62 ITEPA – appeal dismissed***

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**BRIAN GOLDMAN** **Appellant**

**- and -**

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

**TRIBUNAL: JUDGE JOHN WALTERS QC**
**LYNNETH SALISBURY**

**Sitting in public at Bedford Square, London on 17 November 2011**

**The Appellant appeared in person**

**Mrs Christine Cowan, HMRC, for the Respondents**

## DECISION

1. The appellant, Mr Brian Goldman ("Mr Goldman") appeals against an amendment of his self-assessment tax return for the year ended 5 April 2008. The amendment was to include as income chargeable to income tax the whole of the payment of £123,750 made to Mr Goldman on the termination of his employment with SpinVox Limited ("SpinVox"). Mr Goldman's return had been completed on the basis that £93,750 of this sum was chargeable to income tax, but that the remaining £30,000 was not chargeable to income tax as being the first £30,000 of a payment on termination of employment within Chapter 3, Part 6, Income Tax (Earnings and Pensions) Act 2003 ("ITEPA") – see, specifically, section 403(1) ITEPA which provides as follows:

> '(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. The Respondent Commissioners ("HMRC") contend that the payment of £123,750 was not a payment to which Chapter 3, Part 6, ITEPA applies and that, instead, the whole payment counts as earnings from Mr Goldman's employment with SpinVox and is 'earnings' within the general definition in 62 ITEPA, with the consequence that it is 'general earnings' within section 7(3) ITEPA, 'taxable earnings' within section 15(2) ITEPA, 'net taxable earnings' within section 11 ITEPA and therefore within the charge to tax on employment income provided by section 9(2) ITEPA.

3. The Tribunal heard oral evidence from Mr Goldman (who was not cross-examined by Mrs Cowan) and we had before us a bundle of documents. From the evidence we find the following facts.

*The facts*

4. Mr Goldman, before he took employment with SpinVox, was Vice-President (Service Delivery) of a US corporation, Computer Services Corporation. He had an 18-year career with that company. He was attracted to join SpinVox because he saw it as a start-up company (albeit an immature start-up company) in a new area of technology, the translation of voice messages to text messages (a 'virtual messaging conversion system'), with prospects.

5. He took employment with SpinVox on 20 September 2006 (the date of his written Employment Agreement ("the Agreement") as Chief Operating Officer, reporting to the Chief Executive Officer ("CEO") of SpinVox, Ms Christina Domecq ("Ms Domecq"). There is an indication in the correspondence that he commenced the employment on 1 November 2006. His basic salary, before deductions, was £165,000 per annum (Clause 7.1 of the Agreement).

6. Mr Goldman's evidence was that before he took up the appointment with SpinVox, he wanted to ensure a level of protection if he left the employment. That is

why clause 21.3 of the Agreement was included. He wanted to be sure of a quick payment if he left.

7. Clause 21.3 of the Agreement was in the following terms:

> 'In the event of termination of your [Mr Goldman's] contract for any reason other than performance or conduct related issues, the Company [SpinVox] agrees to make a payment in lieu of notice to you within 14 calendar days of the Termination Date equivalent to:
>
> (a) the basic salary that would have been paid to you by the Company; and
>
> (b) the cost to the Company of providing you with any private medical insurance that would have been provided for your benefit by the Company,
>
> during (in each case) a **12 month** [original emphasis] period of notice. The payment in lieu of notice will not take into account any bonuses, commission, holiday entitlement, incentives, car allowance, other employee benefits or any grant or vesting of share/stock options or restricted stock that would have been paid or provided to you or otherwise applicable during the unexpired period of notice. The payment in lieu of notice will be subject to deductions for income tax, employee's national insurance contributions and other deductions required by law.'

8. It is relevant to note that the Agreement also contained, at Clause 19, a provision for 'Garden Leave' – that is provision for Mr Goldman to receive salary and contractual benefits provided by the employment (save for bonuses or commission) during a notice period – whether notice is given by SpinVox or Mr Goldman. However, the notice period is not defined. Mr Goldman told the Tribunal (and we accept) that in his case 'Garden Leave' was never discussed between him and SpinVox.

9. Difficulties arose in the working relationship between Mr Goldman and Ms Domecq. In particular, Mr Goldman thought that Ms Domecq was 'overselling our capabilities'. He enjoyed working for SpinVox but had problems with this relationship with the CEO, Ms Domecq.

10. On 25 June 2007 there was an initial meeting between Mr Goldman and Ms Domecq, at Ms Domecq's instigation.

11. The following day, at 8 am, Mr Goldman met Ms Domecq at a Starbucks coffee shop, again at Ms Domecq's instigation. Mr Goldman was informed that Ms Domecq had decided to terminate his employment. No written notice was given to Mr Goldman.

12. Later that day, at around 3 pm, Mr Goldman was asked to update Ms Domecq in relation to ongoing matters. He was then told not to attend the office for work and his email access was terminated.

13. Shortly after this, at 6.29 pm on the same day, an email announcement was sent to the staff of SpinVox by Ms Domecq in the following terms:

> 'Good Evening Team

> Finally the rains have slowed in the UK and we have a few rays of light ... I was about to build a boat!
>
> SpinVox continues to go from strength to strength as Q2 draws to a close and we focus on the objectives for Q3.
>
> After much deliberation Brian Goldman has opted to move on and explore other pastures, for the immediate future all of his direct reports will report to me. We wish him the best of luck in all of his new endeavours and thank him for his service over the last 6 months.
>
> Watch this space. Alltel, Skype, VodaSpain set to finally sign in the next 10 days!
>
> "Clip In and Climb On"
>
> Christina Domecq'

14. On 28 June 2007 there was a further meeting between Mr Goldman and Ms Domecq to discuss the arrangements that would be made for his termination payment. Mr Goldman told Ms Domecq that he expected SpinVox to honour its obligations under the Agreement. She said that she would need to consult with other directors of SpinVox.

15. On 9 July 2007, Mr Goldman received a draft compromise agreement (of which we did not see a copy) under which SpinVox offered to pay him £165,000 in instalments. Mr Goldman did not want to accept this offer because he had concerns that SpinVox was financially unstable and might not be able to honour its terms.

16. Mr Goldman instructed Mishcon de Reya, solicitors, to act for him in protecting his position.

17. By 10 July 2007 – the expiry of the period of 14 calendar days from 26 June 2007 (the date on which his employment was verbally terminated), no payment had been made to Mr Goldman pursuant to Clause 21.3 of the Agreement.

18. On 17 July 2007, Mishcon de Reya sent an open and a 'without prejudice' letter to the in-house Counsel at SpinVox. The open letter claimed entitlement to 'damages' equal to 12 months' salary and the cost of 12 months of private health care, 'such payments to be made within 14 days of the termination of [Mr Goldman's] employment'. The bulk of the letter addressed the issue that the termination of Mr Goldman's employment was not by 'reason of performance or conduct related issues', and stated that if payment of all sums due to Mr Goldman was not made within 7 days of the date of the letter, proceedings would be issued.

19. The 'without prejudice' letter stated that Mr Goldman was prepared to enter into a compromise agreement but that he would require full payment of the sums due under Clause 21.3 of the Agreement.

20. SpinVox replied in a 'without prejudice' letter dated 19 July 2007, proposing alternative settlement terms, effectively, either a reduced payment (3 months' salary and costs of health care payable within 14 days) or payment 'in full in respect of the maximum payment in lieu of notice' to be paid by instalments. The letter states that

the latter alternative settlement offer 'does not seek any reduction in respect of mitigation (which is now a relevant issue given SpinVox's breach of contract)'.

21. Mishcon de Reya replied, in a 'without prejudice' letter dated 26 July 2007, making the point that SpinVox's admission that it was in breach of contract had certain procedural consequences, and proposing further alternative settlement terms.

22. Subsequently there were verbal negotiations and the upshot was that Mr Goldman's claim was settled on the terms of a compromise agreement dated 27 July 2007 ("the Compromise Agreement"). Mr Goldman accepted less (and payment later) than his entitlement under Clause 21.3 of the Agreement on the basis that to do so removed litigation uncertainty. Pursuant to the Compromise Agreement (Clause 2.1), the sum of £123,750 'by way of payment in lieu of notice, which shall be subject to deductions for income tax and employee's national insurance contributions (as required by law)' was to be paid as to £41,250 within 2 business days after the date of the Agreement, as to £41,250 on 1 October 2007 and as to £41,250 on 2 January 2008. There was additionally provision for payment within 2 business days after the date of the Agreement of the following amounts: £1,500 (before deductions) in lieu of SpinVox's contributions to its healthcare plan, £3,500 by way of additional consideration for the terms and conditions stated in the Compromise Agreement and £9,582.12 in respect of outstanding expenses claims. Further, SpinVox agreed to pay directly to Mr Goldman's solicitors the sum of up to £6,000 plus VAT in respect of legal costs.

23. SpinVox made the payments under the Compromise Agreement but deducted income tax from the whole of the sum of £123,750 (paid in 3 equal instalments as above). The Grounds of Appeal state that Mishcon de Reya wrote to SpinVox objecting to the deduction in respect of the first £30,000, on the basis that it was not required by law. In his self-assessment tax return, Mr Goldman reclaimed the income tax deducted on payment of the first £30,000. As indicated above, HMRC have contended that income tax is due on the whole of the sum of £123,750.

*The parties' submissions*

24. Mr Goldman's case is that the sum of £123,750 was not paid under Clause 21.3 of the Agreement (which admittedly contained a provision for payment in lieu of notice), but was paid 'to settle Mr Goldman's claims against [SpinVox] for wrongfully dismissing Mr Goldman in breach of [the Agreement] and for settling his claim that he was dismissed other than for performance reasons'. It is added in the Grounds of Appeal that '[h]ad Mr Goldman been forced to litigate the matter, he would have argued in the alternative that if his employment were terminated for performance grounds, he would have been entitled to reasonable notice under the [Agreement]'.

25. Mr Goldman in argument made the case that SpinVox had suggested that his employment had been terminated for performance issues and that the negotiation which resulted in the Compromise Agreement was a settlement of a dispute as to the application of Clause 21.3 of the Agreement. He said that he was not enforcing the terms of the Agreement, he was instead settling the dispute as to his entitlement to compensation for termination of his employment for non-performance related issues.

26. Mr Goldman more generally made the point that SpinVox was in breach of the Agreement – in not specifying a notice period, in not making a payment under Clause 21.3 within 14 days, and in not paying the full amount due under Clause 21.3. Moreover, he reminds us that SpinVox had, in terms, admitted being in breach of the Agreement. He submitted that the payment made under the Compromise Agreement was damages for SpinVox's breaches of the Agreement, and was made to avoid litigation rather than to settle a debt, or in the alternative to settle Mr Goldman's claim to be entitled to reasonable notice of the termination of the Agreement.

27. Mrs Cowan, for HMRC, submitted that the payment of £123,750 was in reality made under the Agreement, which was Mr Goldman's contract of employment. She submitted that the reason the payment was made was that Mr Goldman was entitled under Clause 21.3 of the Agreement to the payments therein provided for. She contended that when the Compromise Agreement was entered into the effect was that Clause 21.3 of the Agreement 'became active', albeit in revised terms.

28. She submitted that the source of the payment of £123,750 was the original Agreement. The payment was not a payment of damages outside that Agreement, it was instead a payment in settlement of a dispute over the application of Clause 21.3 of the Agreement. The aim of the Compromise Agreement was to secure (partial) implementation of the Agreement. She contended that there was no significance in the fact that SpinVox had admitted breach of the Agreement.

29. She cited *EMI Group Electronics Ltd. v Coldicott* 71 TC 455 (a decision of the Court of Appeal in 1999), *Richardson v Delaney* 74 TC 167 (a decision of Lloyd J in 2001), *SCA Packaging Limited v Revenue and Customs Commissioners* [2007] STC 1640, a decision of Lightman J, and *Brander, Bocker and McGrotty v HMRC* SpC610, a decision of Special Commissioner Gordon Reid QC in 2007.

30. The Tribunal understood Mrs Cowan to accept that the payment of £3,500 made under Clause 2.1(c) of the Compromise Agreement as additional consideration for the terms and conditions stated in the Compromise Agreement was not an amount of earnings within section 62 ITEPA but was a payment on termination of employment within Chapter 3, Part 6, ITEPA and therefore qualified for the exemption in respect of the first £30,000 of such payments under section 403 ITEPA. This concession (if it was a concession) was rightly made. If income tax has been applied to that payment, Mr Goldman should be credited with any amount deducted.

31. We announced at the end of the hearing that we would dismiss the appeal. Our reasons are broadly that we are in agreement with Mrs Cowan's submissions.

*Reasons for dismissing the appeal*

32. The Court of Appeal in *EMI Group Electronics* held that a payment in lieu of notice made in pursuance of a contractual provision, agreed at the outset of the employment, which enables the employer to terminate the employment on making that payment, is properly to be regarded as an emolument from that employment, falling squarely within the tests posed by Lord Radcliffe in *Hochstrasser v Mayes* 38 TC 673 as being 'paid to him in return for acting as or being an employee' and by

Lord Templeman in *Shilton v Wilmhurst* 64 TC 78 as being 'an emolument from being or becoming an employee'.

33. Chadwick LJ said of a payment in lieu of notice made under an express provision of a contract of employment that the employment may be terminated either by notice or on payment of a sum in lieu of notice, that the payment was not a payment for work done under the contract of employment but neither was it a payment made by way of compensation or damages for breach of the contract of employment (*ibid.* p.489).

34. Chadwick LJ also considered (see *ibid.* at p.490) that the reason why an employee is entitled to a payment in lieu of notice must be that this is the security, or continuity, of salary which he required as an inducement to enter into the employment. Mr Goldman's evidence confirmed that such was his own motivation in requiring the provision for the payment in lieu of notice to be included in the Agreement.

35. There is therefore no doubt that if SpinVox had paid to Mr Goldman a payment in lieu of notice in all respects in accordance with his contractual entitlement under Clause 21.3 of the Agreement, such payment would have ranked as an emolument of his employment, or, in terms of ITEPA, 'earnings' within the general definition in section 62 ITEPA.

36. Why should the character of the payment under the Compromise Agreement be any different? Mr Goldman submits that the payment was derived from the fact that the Agreement was terminated, not from any provision of the Agreement itself and that the key point is that the source of the payment was the settlement of Mr Goldman's claims against SpinVox for wrongful dismissal in breach of contract.

37. We cannot regard that point as made out. All the negotiations which we have described were aimed at enforcing, to the maximum extent attainable in the circumstances, Mr Goldman's contractual entitlement under Clause 21.3 of the Agreement. The fact is that Mr Goldman was unable as a practical matter to obtain full enforcement of that contractual entitlement and was obliged to (and did) settle for less. He settled for less rather than entering into litigation to enforce his full contractual entitlement.

38. There is no real force in Mr Goldman's contention that he was settling a dispute as to whether or not his employment had been terminated for performance issues. This was simply part of the argument about whether he was entitled to the payments stipulated in Clause 21.3 of the Agreement. It was an aspect of the negotiations about enforcement of that entitlement.

39. The payment of £123,750 made under the Compromise Agreement was not in any realistic sense damages for SpinVox's breach of the Agreement. That sum does not relate in any way to the economic consequences of such breaches as SpinVox committed. The payment undoubtedly had its source in Mr Goldman's contractual entitlement under Clause 21.3 of the Agreement – it was as much of that entitlement as Mr Goldman was able as a practical matter to enjoy.

40. The consequence is that the payment of £123,750 made under the Compromise Agreement was 'earnings' within section 62 ITEPA and the appeal must be dismissed.

41. If Mr Goldman's argument were correct, it would be open to anyone entitled to a contractual payment in lieu of notice (which on authority is taxable as 'earnings' within section 62 ITEPA) to accept less, in settlement of his claim to enforce the contractual entitlement, and thus achieve exemption from tax under section 403 ITEPA in respect of the first £30,000. This would not be a sensible result consistent with a purposive interpretation of the legislation.

42. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

**JOHN WALTERS QC**

**TRIBUNAL JUDGE**
**RELEASE DATE: 24 April 2012**