[2018] UKFTT 0240 (TC)

TC06473

Appeal number: TC/2017/1449

INCOME TAX *– Payment by employer – settlement of litigation - whether payment taxable as employment income – whether interest-like element taxable and if so how – s 62 ITEPA 2003 – s 369 ITTOIA 2005*

FIRST-TIER TRIBUNAL
TAX CHAMBER

Mr GEOFFREY PETTIGREW **Appellant**

-and-

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

TRIBUNAL: **Judge Peter Kempster**

Sitting in public at Centre City Tower, Birmingham on 27-28 November 2017

The Appellant appeared in person

Mr Christopher Stone and Ms Georgia Hicks of counsel, instructed by the General Counsel and Solicitor to HM Revenue & Customs, for the Respondents

DECISION

1. The Appellant ("**Mr Pettigrew**") appeals against an enquiry closure notice issued on 30 January 2017 by the Respondents ("**HMRC**") ("**the Closure Notice**"). The Closure Notice amended Mr Pettigrew's self-assessment return for the tax year 2014-15 so as to include a payment made to him in November 2014 of £55,045.42 (**"the Payment"**) by the Ministry of Justice ("**MoJ**").

Background

2. In February 1996 Mr Pettigrew was appointed a part-time Chairman of Industrial Tribunals. Following changes to the structure of the tribunals, that appointment continued as a fee-paid Employment Judge until Mr Pettigrew retired with effect from 31 January 2016.

3. To clarify the terminology, in England & Wales judges may be appointed on a permanent basis, termed "salaried appointment", or – typically where the appointee continues in professional practice – on a part-time non-salaried basis, termed "fee-paid appointment". Salaried judges may also be part-time, in the sense that they are appointed to sit less than five days per week, but in the discussion which follows (and in particular the authorities cited) the term "part-time" is synonymous with "fee-paid".

4. In recent years there has been a series of legal challenges to the policy and practice of MoJ (and its predecessor, the Department of Constitutional Affairs) of treating fee-paid judges differently from salaried judges in relation to pension entitlement, sitting fees, and other remuneration matters.

5. The pension entitlement dispute culminated before the Supreme Court in *O'Brien v Ministry of Justice* [2013] UKSC 6 where the background was explained thus:

> "[1] [Mr O'Brien] is a retired barrister. He also held part-time judicial office as a recorder appointed under s 21 of the Courts Act 1971, as amended. He claims to be entitled to a pension in respect of his part-time non-salaried judicial work. The case raises questions of domestic law about the status and terms of service of part-time non-salaried judges in England and Wales. They include chairmen and members of tribunals and others exercising judicial functions for remuneration. It also raises important questions of EU law as to which, having sought a preliminary ruling under art 267 of the Treaty on the Functioning of the European Union (OJ C83/47 30.3.2010) ('the TFEU'), the court has now received guidance from the Court of Justice of the European Union. …
>
> [5] On 9 June 2005 Mr O'Brien wrote to the Department of Constitutional Affairs requiring that he be paid a retirement pension on the same basis, adjusted pro rata temporis, as that paid to former full-time judges who had been engaged on the same or similar work. He was informed by the Department in its reply dated 5 July 2005 that he fell outside the categories of judicial office holder to whom a judicial pension was payable. This was because the office of recorder was not a qualifying judicial office under the 1993 Act, and because there was no

> obligation to provide him with a pension under European law as he was an office-holder, not a worker.
>
> [6] Mr O'Brien was not satisfied with the reasons he was given. On 29 September 2005 he started proceedings in the employment tribunal in which he claimed among other things that he was being discriminated against because he was a part-time worker. …"

6. Describing the outcome of the CJEU reference the Supreme Court stated:

> "[10] The effect of the questions that were referred, and of the ruling in response to them, is to divide the issues raised by Mr O'Brien's case into two parts. Firstly, there is the worker issue: whether the relationship between judges and the Ministry of Justice is substantially different from that between employers and persons who fall to be treated in national law as workers. The principles to which the Court of Justice refers are of general application. So although the argument was directed to the position of recorders like Mr O'Brien, the issue is of interest to all part-time judges, not just recorders. Secondly, there is the objective justification issue: whether the difference in treatment of part-time judges is justified by objective reasons. The answer to this issue may differ from one kind of non-salaried part-time judge to another. …"

7. On the worker issue, the determination of the Supreme Court (at [42]) was that fee-paid judges are in an employment relationship within the meaning of the relevant EU legislation, and they must be treated as "workers" for the purposes of the UK regulations on part-time workers: The Part-time Workers (Prevention of Less Favourable Treatment) Regulations 2000 (SI 2000/1551) ("**PTWR**"). After dealing with the objective justification issue (also in favour of Mr O'Brien) the Court (at [76]) remitted the case to the Employment Tribunal "for the determination of the amount of the pension to which Mr O'Brien is entitled under the Regulations in accordance with this judgment."

8. Another thread of the disputes related to differences in remuneration between salaried and fee-paid judges for holidays, sickness, writing-up days, training days, London weighting, and sitting fees. In relation to the matters relevant to the current appeal (being sitting fees, training fees and London weighting) those were determined (subject to certain timing issues) against MoJ by the Employment Tribunal in 2014 in *Miller & others v Ministry of Justice* (Case No 1700853/2007 etc) on the basis that the differences constituted less favourable treatment without objective justification.

9. On 27 March 2014 MoJ published a Statement ("**the 2014 Statement**") concerning the *O'Brien* and *Miller* cases. It described how MoJ intended to take matters forward and included the following:

> "**Non-pension related claims**
>
> On a number of non-pension items, the Employment Tribunal in Miller held (where there is a full-time comparator and a claim is within time) that there has been less favourable treatment without objective

justification. The Ministry of Justice is not seeking to appeal against the judgment on these points and is developing policy for them. …

The Miller judgment includes an agreed declaration about the underpayment of daily fees … in the Employment Tribunal from 2000 to 31 March 2013.

Claims handling arrangements

In light of the Miller judgment in respect of past losses …, the Ministry of Justice will implement a claims handling system for eligible fee-paid judicial office holders, as described in the Miller judgment, which will remedy the less favourable treatment. …

If you are a potential claimant and your non-pension claim would have been in time for the purposes of regulation 8(2) of the 2000 Regulations as at 3 June 2013, the Ministry of Justice invites you to particularise your losses and from 1 June 2014 to 31 August 2014 to submit your claim to the Judicial Pay Claims team at the contact address below. The Judicial Pay Claims team will seek to reconcile your claim with Ministry of Justice records in order to arrive at a settlement. This offer applies to eligible fee-paid judicial office-holders in England and Wales, Scotland and Northern Ireland insofar as their potential claim is against the Ministry of Justice."

10. Mr Pettigrew was one of a number of claimants represented by Browne Jacobson, solicitors. The firm wrote to their clients:

"Further to my email of yesterday we have received a number of queries and complaints (nearly 50 so far) about TSol's [ie Treasury Solicitor's Department's] request for supporting evidence of your non pension claims to TSol; and complaints that TSol have not acknowledged receipt. TSol are slow at responding because they have well over 1,500 claimants to deal with. They will however respond to everyone but it may take time.

Please also bear in mind that TSol are only going to pay out on these claims because they are being forced to by this litigation. As with any litigation, claimants have to provide supporting evidence in respect of any claim. If you do not provide them with this information then TSol may not pay. Please do not therefore call or email us to complain about the MoJ's stance. It is extremely time-consuming for us, there is nothing we can do about it and the tribunal is on the MoJ's side in this respect. …

If you do not have complete records or supporting evidence then you should just send them as much as you have. You will then have to wait for the MoJ's response in July as to which claims they accept and which ones they believe will require determination by the tribunal."

11. Mr Pettigrew lodged his claim, stating:

> "Further to the recent advices received from my Solicitors, Browne Jacobson, I am writing to enclose details of my claim for underpayments of training fees and daily rates for sitting and other work as a Fee-paid Chairman of Employment Tribunals/Employment Judge.
>
> Please find enclosed
>
> - Statement summarising personal information
> - Statement of Sitting, Training and other working days
> - Calculation of Claim"

The enclosed calculation of claim was a spreadsheet headed "SHORTFALL CALCULATION".

12. On 27 October 2014 the MoJ wrote to Mr Pettigrew with "a formal offer … in full and final settlement" ("**the MoJ Offer Letter**"). It stated:

> "I write in respect of your claim received by the Judicial Pay Claims team from the Treasury Solicitors on 30th June 2014; I have now had the opportunity to assess your claim and calculated your entitlement as £55.045.42. This letter constitutes a formal offer of that sum in full and final settlement. This offer comprises the following:
>
> ***Compensation in respect of Non Pension payments***
>
> *Training days.* You claimed compensation in respect of all training days undertaken from the 7th April 2000 where only a half day fee was originally paid to you.
>
> The records held by the MOJ, which includes data from the Watford Employment Tribunal and the MOJ payment agent, Liberata, show a total of 44 training days were undertaken during this period up until the end of 2013.
>
> As you were incorrectly paid a half day fee for those dates, when you should have been paid a full days fee, the offer contains the balance between what you were paid and what you should have been paid for each year.
>
> *Sitting days.* You claimed compensation in respect of all sitting days undertaken from the 7th April 2000 where fee paid Employment Tribunal Judges were underpaid in relation to the salaries of salaried Employment Tribunal Judges.
>
> The records held by the MOJ which includes data from the Employment Tribunal and the MOJ payment agent, Liberata, and those records received from yourself, show a total of 1,308.5 sitting days/writing days were undertaken during this period up until the end of 2013.

As you were paid the incorrect daily fee for those dates, the offer contains the balance between what you were paid and what you should have been paid for each year.

London Weighting: You claimed compensation for London Weighting. London Weighting is a £4,000 annual supplement for Group 7 salaried judges and is only applicable to those who work in London. Fee paid judges are eligible to a pro rata amount of London Weighting based on the number of sittings you sat, and only for the years where you sat at eligible courts. As a result you are eligible for a further 1,352.5 sitting and training days at the daily London Weighting rate, which is £4,000 divided by the relevant daily divisor (220 days for an Employment Tribunal Judge), i.e. £18.18 per day.

Following the assessment of this data I used the conversion spreadsheet (enclosed) which calculates the difference in the amount you were actually paid and the amount that you should have been paid as a fee paid Employment Tribunal Judge each year, which amounts to £55,045.42. Please note that an interest like element of compensation hasbeen included in this sum based on the Preston index rate, which is the method of interest that has been agreed with the claimant solicitors in the Employment Tribunal Litigation.

Please note that the MOJ Judicial Pay Claims team is only obliged to make you an offer based on less favourable treatment post 7th April 2000 and prior to 31st December 2013. In your claim, any under payment/less favourable treatment after 2nd January 2014 is being dealt with separately from this process by HMCTS and the Judicial College.

If you accept this offer please confirm in writing to [MoJ] confirming your address, your bank details, your payroll number and national insurance number and I will arrange payment to you. If you reject this offer please set out your reasons to the above email address and be prepared to supply the Ministry with evidence as to why you feel unable to accept this offer.

This offer will be taxed in accordance with HMRC rules. Payments in relation to sitting days, training, sick absence, London Weighting and Statements of Reason will be subject to PAYE and National Insurance payments. Payments in relation to a payment in lieu of a pension will be subject to PAYE. Tax will not be paid on the interest on this amount. Any issues you have with the tax treatment being applied to your offer should be made with your local HMRC office."

13. On 2 November 2014 Mr Pettigrew accepted the offer.

14. Mr Pettigrew submitted his 2014-15 self-assessment tax return on 21 August 2015 and in a covering letter he fully disclosed that:

(1) The figures entered for employment income were different from those on his Form P60;

(2) He had received £55,045 (inclusive of interest) as a payment of compensation, from which approximately £22,000 PAYE had been deducted;

(3) He believed "… deduction of tax was incorrect in that the amount paid represented not arrears of wages or salary, but the damages for the statutory tort of breach of the [PTWR]. It is well settled that payment of compensation for the statutory tort of discrimination under the Equality Act 2010 is not susceptible to tax, unless made on termination of employment. As was conceded in [*Oti-Obihara* - citation below] ..."; and

(4) He referred to the case of *A v HMRC* (citation below).

15. On 16 December 2015 HMRC (Mrs Smith at PAYE & SA) wrote to Mr Pettigrew:

> "Whilst I have noted the comments you have made in respect of the payment you received from the Ministry of Justice by way of compensation under the Part-time Workers (Prevention of Less Favourable Treatment) Regulations 2000, I am writing to inform you that all the correspondence relating to these payments has now been reviewed by a HMRC Specialist Officer. I have been advised HMRC views the payment made as making good an accepted past entitlement, and the amounts making up the aggregate payment (if paid at the correct time) would have been chargeable to tax as employment income by virtue of being general earnings from the employment.
>
> Therefore, the amount of the corrective payment is chargeable to tax and NICs as employment income."

The letter cited the legislative provisions, and on the same date the return was corrected (s 9ZB Taxes Management Act 1970 refers) to, in effect, add the Payment to the employment income.

16. On 24 December 2015 Mr Pettigrew replied to HMRC's letter dated 16 December, stating "I wish to appeal against the tax assessment." He was not satisfied by HMRC's speed of response and on 29 February 2015 he chased HMRC, stating, "I wish to complain that my request for review of my assessment for 2014/15 has not been dealt with following my letter of 24 December. Please note I want to appeal it [ie the 2014-15 adjustment]." Because (I assume) of the reference in that letter to a complaint, the correspondence was routed to HMRC's Complaints Service and, after a holding reply on 14 March 2016, HMRC (Mr Williams at Complaints Service PAYE & SA) wrote on 11 May 2016. Although this letter ("**the Complaint Letter**") ostensibly refers to the complaint, the explanation of HMRC's position which it contains was cross-referred in the Closure Notice and, therefore, it is relevant to quote that explanation at length:

> "The key point at issue that you raise is whether the lump sum payment of £55,045.42, (of which £6,186.32 was classed as interest), received by you from your employer, as detailed on your payslip dated 18

November 2014 is compensation or employment income, specifically earnings.

Employment income is charged to tax under the provisions of Part 2 Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003), all future references to sections in this letter refer to ITEPA 2003 unless specified otherwise. Section 6(1)(a) provides that the charge to tax on employment income under Part 2 is a charge to tax on “general earnings" and section 7(3)(a) states that "general earnings” means earnings within Chapter 1 of Part 3, which consists only of section 62. Section 9(2) provides that the amount charged to tax is the net taxable earnings (calculated in accordance with the formula given by section 11 (1)) from an employment in the year. Consequently, an amount is chargeable to tax as employment income by virtue of being earnings from an employment if it is within the meaning of "earnings", given by section 62 ITEPA 2003, and is from an employment.

Section 62(2)(b) states that “earnings” in relation to an employment means any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth. As you clearly received money the critical issue, is whether that payment is "from an employment".

There is a long line of case law authority regarding the matter of whether a payment is derived "from an employment" albeit stated in terms of the previous terminology of "emoluments therefrom". Many of the cases demonstrate relatively fine distinctions between payments that were held to be chargeable to tax and those that were not. In particular, Case Law authority has moved on from the classic, but perhaps simplistic, “reward for services" formulation in Hochstrasser v Mayes (38TC693).

The present position is probably best summed up by the brief observation of Lord Reid in Laidler v Perry (42TC351), where he said (at page 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 cases 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."

In Bray v Best (61TC104) Lord Oliver disposed of the “reward for services" point this way:

> '"In the light of those authorities, I cannot read the phrase "reward for services" as anything more than a conventional expression of the notion that a particular payment arises from the existence of the employer-employee relationship and not, to

> use Lord Reid's words in Laidler v Perry, from “something else”.”

And in Shilton v Wilmshurst (64TC78), Lord Templeman explained the statutory words in this way:

> "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. "

Payments resulting from claims in accordance with the Miller case (1700853/2007)

It is worth recognising that there is often a fine line between whether something is employment income, or compensation from something else. However, HMRC has previously considered the tax consequences of payments made to Ministry of Justice (MOJ) employees following the Miller case. It is HMRC's view that the payments should be treated as earnings and are therefore subject to deduction of PAYE and National Insurance contributions.

The Employment Tribunal conclusions in the Miller case were that the fees paid to the claimants for performing certain duties of their offices were insufficient for a variety of reasons in comparison to the remuneration of full-time salaried colleagues. The MOJ's remedy was to recalculate the amounts that the individuals concerned were entitled to receive and make a payment to make good the shortfall.

HMRC views the payments made, such as that to you, detailed in your payslip of 18 November 2014, as making good an accepted past entitlement, and the amounts making up the aggregate payment, (if paid at the correct time), would have been chargeable to tax as employment income by virtue of being general earnings from the employment. The amount of the corrective payment will be chargeable to tax and NICs as employment income.

Legally, an employee’s tax liability on a payment of arrears arises in the tax year that the employee was originally entitled to be paid the extra amounts, not in the year that payments are eventually made. In contrast, National Insurance Contributions are due on payment. The MOJ as the employer had a statutory duty to operate PAYE and was legally required to deduct tax on these payments and pay them over to HMRC.

Where possible the MOJ should have calculated the tax due for all closed tax years and deducted tax under PAYE. If arrears are paid in one lump sum in the current tax year then PAYE is due at the time of payment. Where the employee queries the reconciliation. they have the right to ask HMRC that the arrears are related back to the year in which

they should have been paid if doing so would be beneficial for the employee. For instance, if the lump sum is taxable at higher rate in the year it is paid, but would have been taxed at basic rate if paid in the year in which entitlement arose.

Your contention is that you were not contractually entitled to the lump sum payment that you received and that this lack of contractual entitlement is the basis of the appeals to the Employment Tribunal. Your view, if I understand it correctly. is that the lump sum payment can't be earnings because it wasn't specified as receivable in your employment contract. Section 62 doesn't specify that amounts are only earnings if they are contractual. It is entirely possible and indeed relatively common for employees to receive non-contractual payments that are nevertheless taxable as earnings. As discussed above, where a payment is money, or money's worth and from the employment then it will be taxable as earnings.

The Tribunal in the Miller case found that the contractual terms for part-time employees were unfair. Under the terms of the Part Time Worker Regs fee paid judges were entitled to receive the same level of earnings for certain work done as their full-time colleagues. The lump sum payments made to employees by the MOJ represent amounts that those employees were entitled to for work carried out in previous years in their capacity as part time judges. If they had been made at the correct time they would have been taxable as earnings. The fact that these payments are being made in arrears does not change the character, or taxability of the payments.

Compensation

In a previous letter to HMRC you referred to the tax tribunal case of Mr A v Commissioners for HMRC [2015] UKFTT 0189 (TC 04381) in support of your view that the lump sum you received is not taxable as earnings within the meaning given by section 62. Your view is that the lump sum you received was compensation and not a payment of arrears of earnings which you were entitled to for past service as a part time employee. In particular, you are suggesting that the basis of the calculation to determine the lump sum amount is not determinative that it is earnings.

Firstly, it is worth highlighting that the case of A was a First Tier Tribunal (FTT) case and therefore has no precedent value. However, that is not to say we wouldn’t consider the decision when reviewing the facts of other similar cases.

Secondly and more significantly, your circumstances can be distinguished from those in the case of A. The FTT found that the payment made to A was to compensate for an actual or potential action against discrimination. It was rejected that the payment was earnings despite the amount being calculated based on bonus payments. Furthermore, the tribunal made a finding of fact that the payment to A was not from his employment; it was not for past or future services.

> Even though it was a payment from his employer, it was found that the source of the payment was something other than his employment. In that particular case it was for giving up any future action against his employer. In contrast you have received a lump sum payment representing arrears of earnings. In line with the decision in the Miller case, you were entitled to amounts of earnings in previous years despite what was included in your employment contract. These earnings have now been paid to you by way of a lump sum and are taxable as earnings.
>
> In addition to the payment of arrears of £48,859.10, you also received an additional payment to compensate for the fact that your earnings were paid late. Your 18 November 2014 payslip shows this amount as 'Interest Payment £6,186.32'. This payment is not actually interest but is interest-like and calculated as if it were interest. It is taxable in principle as miscellaneous income in the year it is paid. It is not a payment of employment income and therefore was not subject to PAYE. The amount should have been paid gross to you and then you would have been required to declare the income and pay the appropriate tax due through your Self-Assessment return.
>
> I understand there was some confusion about these payments such that the MOJ incorrectly deducted tax under PAYE and paid the 'interest' amounts net to employees as they have in your case. The MOJ has now amended their approach to dealing with these 'interest' payments and will be paying them gross going forward.
>
> …
>
> You have paid all of the income tax you are due to pay for 2014-15.
>
> I understand that the response above is not the outcome you would have hoped for but I trust that the explanation above has clarified HMRC's position on the matter.
>
> I therefore hope you are satisfied with the outcome of your complaint. …"

17. There was further correspondence relating to the customer complaint, which I do not need to describe for the purposes of these proceedings.

18. On 22 July 2016 HMRC (Mr Davies) opened an enquiry into Mr Pettigrew's 2014-15 tax return (s 9A TMA 1970 refers). On 2 August Mr Pettigrew supplied further copies of information requested by HMRC. There is nothing further in the trial bundle until the Closure Notice, on 30 January 2017, and so I assume there was no other important correspondence – which is not surprising, as this was in effect an "aspect enquiry" and Mr Pettigrew had supplied all the relevant information. The Closure Notice states:

> "I have now completed my check of your Self Assessment tax return for the year [ended 5 April 2015]. This letter is a closure notice issued

under Section 28A(1)& (2) Taxes Management Act 1970. Thank you for your help during my check.

My decision

Further to the explanation provided to you in HMRC's letter of 11 May 2016, briefly stated, the lump sum paid to you by the Ministry of Justice was a payment made for the performance of the duties of an Employment Tribunal judge.

The payment recognised the fact that, under the terms of the Part-time Workers (Prevention of Less Favourable Treatment) Regulations 2000, part-time employees were entitled to receive the same level of payment for work done as their full-time colleagues. Payment of the full amount should have been made at the time that the work was carried out and if this had been the case the payment would have been correctly taxed as earnings from the employment.

The payment of the lump sum is therefore a payment of earnings within the meaning of section 62 of the Income Tax (Earnings and Pensions) Act 2003 and a tax liability arises accordingly. The correct total amount of pay from all employments for 2014-2015 is therefore £71,169 as shown on the P60 completed by the Ministry of Justice, and not the figure of £16,142 shown on your Self Assessment Tax Return.

I have amended your tax return in line with my decision. …"

19. On 2 February 2017 Mr Pettigrew appealed to the Tribunal against the Closure Notice.

Statutory Law

20. Sections 6 & 7 Income Tax (Earnings and Pensions) Act 2003 ("**ITEPA**") include within the charge to tax on employment income "earnings within Chapter 1 of Part 3". That Chapter consists of just s 62, which provides (so far as relevant):

"**Earnings**

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

(2) In those Parts "earnings", in relation to an employment, means—

(a) any salary, wages or fee,

(b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or

(c) anything else that constitutes an emolument of the employment. …"

21. Many of the authorities cited to the Tribunal refer to the statutory provisions pre-ITEPA, where the test was whether an amount constituted an emolument *from* the employment rather than "an emolument *of* the employment". I do not consider that change has any effect on the precedent value of the authorities, and I understand a similar approach has been taken by the higher courts in post-ITEPA cases – for example, Lord Hodge in *Rangers* (cited below) (at [35]): "That which was an emolument under prior legislation remains an emolument under ITEPA."

22. Section 5 ITEPA provides (so far as relevant):

> "**Application to offices and office-holders**
>
> (1) The provisions of the employment income Parts that are expressed to apply to employments apply equally to offices, unless otherwise indicated.
>
> (2) In those provisions as they apply to an office—
>
> (a) references to being employed are to being the holder of the office;
>
> (b) "employee" means the office-holder;
>
> (c) "employer" means the person under whom the office-holder holds office. …"

23. Turning to the statutory provisions relating to interest, Income Tax (Trading and Other Income) Act 2005 ("**ITTOIA**") provides (so far as relevant):

> "**369 Charge to tax on interest**
>
> (1) Income tax is charged on interest. …
>
> **370 Income charged**
>
> (1) Tax is charged under this Chapter on the full amount of the interest arising in the tax year. …
>
> **371 Person liable**
>
> The person liable for any tax charged under this Chapter is the person receiving or entitled to the interest."

24. The provision in ITTOIA relating to miscellaneous income is s 687:

> "**687 Charge to tax on income not otherwise charged**
>
> (1) Income tax is charged under this Chapter on income from any source that is not charged to income tax under or as a result of any other provision of this Act or any other Act."

25. The relevant provisions of the PTWR are:

"**Reg 5 Less favourable treatment of part-time workers**

(1) A part-time worker has the right not to be treated by his employer less favourably than the employer treats a comparable full-time worker—

(a) as regards the terms of his contract; or

(b) by being subjected to any other detriment by any act, or deliberate failure to act, of his employer.

(2) The right conferred by paragraph (1) applies only if—

(a) the treatment is on the ground that the worker is a part-time worker, and

(b) the treatment is not justified on objective grounds. …

Reg 8 Complaints to employment tribunals etc.

(1) Subject to regulation 7(5), a worker may present a complaint to an employment tribunal that his employer has infringed a right conferred on him by regulation 5 or 7(2). …

(7) Where an employment tribunal finds that a complaint presented to it under this regulation is well founded, it shall take such of the following steps as it considers just and equitable—

(a) making a declaration as to the rights of the complainant and the employer in relation to the matters to which the complaint relates;

(b) ordering the employer to pay compensation to the complainant;

(c) recommending that the employer take, within a specified period, action appearing to the tribunal to be reasonable, in all the circumstances of the case, for the purpose of obviating or reducing the adverse effect on the complainant of any matter to which the complaint relates. …

(9) Where a tribunal orders compensation under paragraph (7)(b), the amount of the compensation awarded shall be such as the tribunal considers just and equitable in all the circumstances (subject to paragraph (8)) having regard to—

(a) the infringement to which the complaint relates, and

(b) any loss which is attributable to the infringement having regard, in the case of an infringement of the right conferred by

regulation 5, to the pro rata principle except where it is inappropriate to do so.

(10) The loss shall be taken to include—

(a) any expenses reasonably incurred by the complainant in consequence of the infringement, and

(b) loss of any benefit which he might reasonably be expected to have had but for the infringement.

(11) Compensation in respect of treating a worker in a manner which infringes the right conferred on him by regulation 5 shall not include compensation for injury to feelings.

(12) In ascertaining the loss the tribunal shall apply the same rule concerning the duty of a person to mitigate his loss as applies to damages recoverable under the common law of England and Wales or (as the case may be) Scotland.

(13) Where the tribunal finds that the act, or failure to act, to which the complaint relates was to any extent caused or contributed to by action of the complainant, it shall reduce the amount of the compensation by such proportion as it considers just and equitable having regard to that finding. …"

Case Law

26. The following authorities were cited to the Tribunal. It is convenient to list them here, with a shorthand title for those that I refer to below.

Case	Court	Citation	Shorthand name
Henry v Foster	House of Lords	(1932) 16 TC 605	
Dewhurst and another v Hunter	House of Lords	[1932] All ER Rep 753	
Cameron v Prendergast	House of Lords	[1940] AC 549	*Cameron*
Riches v National Westminster Bank	House of Lords	[1947] AC 390	*Riches*
Hochstrasser v Mayes	House of Lords	[1960] AC 376	*Hochstrasser*
Laidler v Perry	House of Lords	[1966] AC 16	*Laidler*
Comptroller-General of Inland Revenue v Knight	Privy Council	1973 AC 428	
Brumby v Milner	House of Lords	[1976] STC 534	*Brumby v Milner*
Bray v Best	House of Lords	[1989] STC 159	*Bray v Best*
Shilton v Wilmshurst	House of Lords	[1991] STC 88	*Shilton*
Mairs v Haughey	House of Lords	[1993] STC 569	*Mairs v Haughey*
Tower MCashback	Supreme Court	[2011] STC 1143	*Tower MCashback*

LLP 1 & anor v HMRC			
O'Brien v Ministry of Justice	Supreme Court	[2013] UKSC 6	*O'Brien*
RFC 2012 plc (in liq'n) v AG for Scotland	Supreme Court	[2017] STC 1556	*Rangers*
Henley v Murray	Court of Appeal	[1950] 1 All ER 908	*Henley v Murray*
Dale v de Soissons	Court of Appeal	[1950] 2 All ER 460	
London & Thames Haven Oil Wharves Ltd v Attwool	Court of Appeal	[1967] AC 772	*London & Thames Haven*
Brumby v Milner	Court of Appeal	[1975] 3 All ER 1004	
Hamblett v Godfrey	Court of Appeal	[1987] STC 60	*Hamblett v Godfrey*
Wilson v Clayton	Court of Appeal	[2005] STC 157	*Wilson v Clayton*
Kuehne + Nagel Drinks Logisitics Ltd v HMRC	Court of Appeal	[2012] STC 840	*Kuehne + Nagel*
Murray Group Holdings Ltd v HMRC	Court of Session, Inner House	[2016] STC 468	*Murray Group*
Bridges v Hewitt & Bearsley	High Court	(1957) 37 TC 289	
Holland v Geoghegan	High Court	[1972] 1 WLR 473	*Holland v Geoghegan*
Re Euro Hotel (Belgravia) Ltd	High Court	[1975] STC 682	*Re Euro Hotel*
Kuehne + Nagel Drinks Logistics Ltd and others v HMRC	Upper Tribunal	[2011] STC 576	
Martin v HMRC	Upper Tribunal	[2015] STC 478	
Fidex Ltd v HMRC	Upper Tribunal	[2015] STC 702	*Fidex*
Moorthy v HMRC	Upper Tribunal	[2016] STC 1178	*Moorthy*
Tottenham Hotspur Ltd v HMRC	Upper Tribunal	[2018] STC 81	*Tottenham Hotspur*
Walker v Adams	Special Commissioners	[2003] STC (SCD) 269	
Kuehne + Nagel Drinks Logistics Ltd and others v HMRC	FTT	[2010] SFTD 298	
Oti-Obihara v HMRC	FTT	[2010] UKFTT 568 (TC)	*Oti-Obihara*

A v HMRC	FTT	[2015] UKFTT 0189 (TC)	*A v HMRC*
Tottenham Hotspur Ltd v HMRC	FTT	[2016] UKFTT 0389 (TC)	
Reid v HMRC	FTT	[2016] UKFTT 0079 (TC)	
Miller & others v Ministry of Justice	Employment Tribunal	Case No 1700853/2017 etc	*Miller*

Appellant's case

27. Mr Pettigrew submitted as follows.

28. The Payment does not constitute employment income from the office of fee-paid judge. The Closure Notice was wrong to treat the Payment as merely a back payment of a contractual entitlement; instead it was a payment of a sum of compensation or damages for a statutory tort under the PTWR.

29. Whether a payment arises from the employment is a question to be answered in the light of the particular facts of the case: *Hochstrasser.* The question is, "did this profit arise from the employment? The answer will be no if it arose from something else.": per Lord Reid in *Laidler*. The fact that the recipient is an employee is insufficient: per Patten LJ in *Kuehne + Nagel.* Per Viscount Simonds in *Hochstrasser*: "… the issue turns … upon whether the fact of employment is the causa causans, or only the sine qua non of benefit." The onus is on HMRC to prove that a payment is taxable: *Hochstrasser*.

30. There was no contractual entitlement to the Payment – either actual or implied, nor vested or contingent. The Payment clearly arose from the *O'Brien* and *Miller* litigation, and that litigation was the sole reason why the Payment was made. Mr O'Brien had been in litigation for some seven years before MoJ was obliged to sttle claims of fee-paid judges stood behind *O'Brien*. MoJ had stated that it would not pay on out-of-time claims, so there was no general recognition or acceptance that payments were due to all fee-paid judges as of right; MoJ would not be paying "back pay" to fee-paid judges who had not filed a discrimination claim in time. It was irrelevant that payment was made in settlement of litigation rather than pursuant to a judgment: *Henley v Murray*. MoJ had accepted Mr Pettigrew's entitlement, and also accepted his computation of claim without compromise. The Payment was made for concluding the litigation, not for giving services. There was not even a substantial connection between the Payment and the employment contract (*Kuehne + Nagel*) – that was shown by MoJ's stance throughout the litigation.

31. Where an employee enforces some right which has been infringed by an employer then the resulting payment (other than on a termination) by way of damages, or a compromise payment, is not earnings from employment. This is so even where the payment is calculated by reference to loss of earnings: *Wilson v Clayton; A v HMRC; Tottenham Hotspur; Oti-Obihara.* Here the payment was received not in return for

services but because it has been determined that the employer acted unlawfully by discriminating against the individual, and the employer was ordered to make a payment of damages. An award of compensation under the PTWR is entirely on all fours with an award for any other form of discrimination (eg under the Equality Act 2010). Unlike equal pay cases, PTWR does not provide for the insertion of an "equal pay clause" into the contract; the sole remedy is damages. In other discrimination cases the reason for payment is to relieve the personal distress of an employee; here the employee received a payment to relieve the disadvantage (and thus distress) of having been discriminated against; the payment was personal to the individual because he was a litigant, not because he was an employee/worker. The wording of the claim might use terms familiar from an employment relationship but the claim was for compensation under the PTWR, not a contractual claim for remuneration.

32. HMRC were mistaken to rely on a "substitution principle" derived from *Mairs v Haughey*. In that case Lord Woolf had distinguished the position where there is a cause or reason for the payment separate from the employment. That was the position in the current case; the real and legitimate reason for the payment was the employer's breach of the PTWR and the payment of damages for that breach; the payment did not arise out of the employment contract. For a substitution there must be something to substitute for; here there was nothing in the contract to pay in lieu of – the payment arose from a separate cause, being the breach of the PTWR.

33. It was accepted that if MoJ had paid the full fees at the time that the duties were performed then the sums received would have been taxable as earnings. However that was not what had occurred; instead MoJ had not paid at the time the duties were performed, and had resisted payment throughout the lead cases litigation (over some seven years), and only offered to settle when MoJ lost in *Miller*.

34. The current case was analogous to *A v HMRC*. There the compensation was paid for race discrimination suffered; here it was paid for discrimination suffered because of part-time status. Although the Tribunal Judge in *A v HMRC* did not specifically cite *Mairs*, all the leading authorities were considered and the correct test was applied: "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'." The calculation of the damages was by reference to the claimant's earnings. HMRC did not appeal the decision in *A v HMRC*.

35. That was in accordance with the guidance in HMRC's own Employment Income Manual at EIM 12965:

> "Any part of the settlement that can reasonably be attributed to discrimination occurring before the termination should be accepted as not being employment income as it is not "connected" with the termination. However, where the compensation relates only to the consequences of the termination itself, no apportionment will be appropriate. For example, if the compensation is for loss of future earnings (after termination) it is all connected with the termination and Section 401 ITEPA 2003 applies even though the discrimination

> brought about the termination. If, by contrast, the compensation is for injury to feelings and there was discrimination before termination, then any part of that compensation that is not connected with the termination will not be within Section 401 ITEPA 2003."

The Interest-like Payment

36. HMRC's current case is that £6,186.32 of the payment is taxable as miscellaneous income, alternatively interest income. That was not how it was treated in the Closure Notice, where it was part of "pay from employments".

37. This element is merely part of the payment of compensation under art 8 PTWR. If the Appellant had been paid pro rata to a full-time worker then he would have had the benefit of extra income; he lost that benefit and the payment of interest recompenses him for the loss of that income – it is compensation for keeping him out of his money for some 13 years.

Respondents' case

38. Mr Stone submitted as follows for HMRC.

39. The breadth of the definition of earnings in s. 62(2)(c) has been stressed recently by the Supreme Court in *Rangers* and the Court of Session in *Murray Group*:

> "The critical feature of an emolument and of earnings as so drafted is that it represents the product of the employee's work – his personal exertion in the course of his employment": Court of Session at [53]

> "… income tax on emoluments or earnings is due on money paid as a reward or remuneration for the exertions of the employee": Supreme Court at [58]

> "The relevant provisions for the taxation or emoluments or earnings were and are drafted in deliberately wide terms to bring within the tax charge money paid as a reward for an employee's work": Supreme Court at [64]

40. In order for a sum of money to be "from employment", there must be some causal connection between the employment and the emolument received. However, not every payment received from an employer is an emolument "from employment": *Laidler*. Although the distinction between those payments which are and those which are not "from employment" has previously been put in terms of whether the employment was the *causa causans* rather than the *sine qua non* of the payment, the lack of utility in distinguishing two Latin phrases of uncertain meaning was made clear by Lord Simon in *Brumby v Milner.*

41. A payment is an emolument from employment if it is "paid to him in return for acting as or being an employee": *Hochstrasser*. The Tribunal in this case should ask whether the Payment arose from "the employer-employee relationship", from "being

or becoming an employee"; or from something else: *Bray v Best; Shilton; Laidler; Brumby v Milner; Kuehne + Nagel*.

42. Even if there are other reasons for a payment being made, the causal link between the employment and the payment of the emolument will be satisfied if the employment was a "substantial cause" of the payment, or "a sufficiently substantial reason for the payments": *Kuehne + Nagel.*

43. A payment may be an emolument from employment notwithstanding that it is paid in a lump sum: *Brumby v Milner; Bray v Best; Holland v Geoghegan; Hamblett v Godfrey; Cameron.*

44. A payment made in compensation for loss of rights which are connected with the employment can be an emolument from employment: *Hamblett v Godfrey*. In *Holland v Geoghegan* a payment made as "a form of substituted remuneration" was found to be an emolument of the taxpayer's employment notwithstanding that the main purpose of the payment was to get the taxpayer and other refuse collectors back to work.

45. A payment which is made in substitution for a contingent right to a payment will ordinarily derive its nature or character from the nature of the payment which it replaces (and will therefore be taxed as that payment would have been): *Mairs v Haughey*. This is consistent with the approach that the Courts have taken to the issue of whether a damages payment received is capital or income: *London & Thames Haven*.

46. In order to be an emolument from employment the right to a payment does not have to be found in the contract of employment. For example:

(1) in *Kuehne + Nagel* the payment resulted from the threat of strike action;

(2) in *Holland v Geoghegan* the payment was a compromise reached following strike action;

(3) in *Laidler* there was no contractual right to a Christmas voucher;

(4) in *Hamblett v Godfrey* there was no contractual right to the payment in recognition of the loss of rights derived from employment protection legislation.

47. The fact that a payment is calculated by reference to the duties of employment that have been performed or the service given as an employee may not by itself be determinative, but it is a very strong pointer in favour of the sum received being from the employment: *Brumby v Milner*. The burden of proof was on Mr Pettigrew: s 50 TMA 1970.

48. The Payment was received in satisfaction of Mr Pettigrew's claim for statutory compensation because he had not received the payments to which he was lawfully

entitled at the time. Whilst a payment does not have to relate directly to the duties of employment to be an emolument therefrom (provided there is a sufficient connection with the employment (see e.g. *Hamblett v Godfrey*)), in this case there is a direct link between the duties that were performed and the payment received:

(1) The claim against MoJ was for monies that Mr Pettigrew ought to have received when paid for those duties.

(2) The Offer Letter was couched in terms of the payments that were made having been "incorrect", accepting that Mr Pettigrew ought to have been paid a greater sum at the time.

(3) The Payment was calculated directly by reference to the actual duties that Mr Pettigrew performed. He received a certain sum for each of the different types of duties performed. If he had performed fewer duties then he would have received a lower sum; if he had performed more duties then he would have received a greater sum.

49. The payment was received specifically because the Appellant had carried out the duties of his employment. The PTWR confers rights on part-time employees to certain treatment *vis a vis* full-time employees. The rights under the PTWR are directly connected with, and could not exist without, the employment relationship (as were the rights created by the employment protection legislation in *Hamblett v Godfrey*) and did not create a standalone right to a payment from a source other than the employment. Mr Pettigrew's employment was therefore a sufficiently substantial cause of the payment received: *Kuehne + Nagle*.

50. Whilst the payment followed the issue of a claim to an Employment Tribunal, it was a sum of money which Mr Pettigrew had the right to receive at the time (under the relevant legislation), and which he would have received if MoJ had acted lawfully. The Payment constituted deferred remuneration for the duties performed. If MoJ had acted lawfully and paid the full fees at the time that the duties were performed then the full sums received would have been taxable as earnings. The fact that Mr Pettigrew issued a claim and that the Payment was subsequently received as a lump sum does not change the character of the Payment. Neither does the fact that the claim was for a form of discriminatory treatment rather than, say, a claim for unlawful deduction of wages or breach of contract. The Payment takes its character from the taxability of the sums to which Mr Pettigrew was entitled as of right and in respect of which the Payment was made. Mr Pettigrew was entitled to be paid in accordance with his rights under the PTWR. The sums which should have been paid would have been taxable and the Payment in compromise of a claim to those sums is of the same character.

51. The only caselaw authority that might support Mr Pettigrew's contentions is the First-tier Tribunal case of *A v HMRC*. That decision was not binding on this Tribunal and (although HMRC did not appeal onwards) HMRC considered it was wrongly decided; that view was also supported by the leading textbook *Harvey on Industrial Relations and Employment Law* (paragraph 71 of Division BII). The Tribunal

recognised (at [74]) that its approach was unsupported by any authority, either authoritative or even persuasive. The Tribunal was in error as follows:

> (1) The Tribunal appears to have taken the phrase "reward for services" too literally. The phrase means nothing more than that the "payment arises from the existence of the employer-employee relationship and not … from 'something else'" (*Bray v Best* per Lord Oliver at 167d). As Lord Reid said in *Laidler*, "reward … is not apt to include all cases which can fall within the statutory words".
>
> (2) The Tribunal was not referred to the case of *Kuehne + Nagel*. The Tribunal's binary approach to the s. 62 question led it to impermissibly discount the character of the sums that the payment was compensating and focus solely upon the proximate cause of the payment. It is sufficient to bring the payment within the charge to tax that the employment relationship was a "substantial cause" of the payment.
>
> (3) In saying that an award of damages for discrimination would be treated in like manner to a tort claim, it appears that the Tribunal may have been proceeding on the assumption that damages awarded by a court following a successful tort claim could not be earnings from employment. If so, there is no authority that establishes that proposition.
>
> (4) When analysing why the payment was made, the Tribunal failed to take into account the substitution principle. That is to say, it failed to characterise the payment by reference to the sum it substituted. As noted in *Harvey*, the Tribunal was not referred to the case of *Mairs v Haughey*.

52. In *Moorthy* the Upper Tribunal mentioned *A v HMRC* but neither endorsed nor disputed the FTT's conclusions. In any event, in the current appeal the sum paid by MoJ was not "recompense for the right not to be discriminated against under statute"; it was a sum that was to compensate Mr Pettigrew for the fact that when performing the services of his employment he did not receive the full amount to which he was lawfully entitled. The payment had the effect that he was properly paid for the services that he performed.

53. A number of the cases cited by Mr Pettigrew concern situations in which a contract came to an end; the termination of employment cases, of course, but also *Henley v Murray* and *Tottenham Hotspur* where an entire contract was abrogated.

54. Mr Pettigrew focused too closely on the mechanism of payment (that the Payment followed a tribunal claim) rather than the important issue: what was the Payment for? The proximate cause of the Payment was the settlement of the *Miller* litigation, but that did not determine the nature of the Payment. The litigation was only possible and productive because of the employment relationship.

55. Mr Pettigrew was wrong to contend that if an employee enforces some right to a payment (other than on a termination) which has been infringed by the employer, then the resulting payment by way of damages (or a compromise payment) is not earnings

from employment. That contention was incorrect and (absent *A v HMRC*) not supported by authority. The authorities cited by Mr Pettigrew are cases where sums were held not to be emoluments from employment for quite separate reasons, rather than simply because there had been a claim to enforce a right.

(1) *Oti-Obihara* concerned whether or not a payment received in compromise of a discrimination claim following termination of employment fell within s.401 ITEPA; it was not concerned with earnings under s. 62 ITEPA (and in any event on the point that *Oti-Obihara* decided, the Upper Tribunal said in *Moorthy* that it was wrong and should not be followed).

(2) *Tottenham Hotspur* was concerned with a total surrender of the employees' rights under their contracts of employment and the specific principle in *Henley v Murray*; it does not establish that because there was a compromise agreement the sums received were not taxable.

(3) *Wilson v Clayton* was decided on the basis that the payment received was a direct consequence of the termination of the taxpayer's employment; the payment was a compromise of a claim for unfair dismissal, but the taxability of the sum was not decided on that basis.

(4) The payments made in *Kuehne + Nagel* and *Holland v Geoghegan* were both made as compromises of employment disputes. That fact did not prevent them being emoluments from employment.

56. In relation to the "interest-like payment" this fell to be taxed according to the principles in *Riches* and *Re Euro Hotel*. The position in the Closure Notice may be reasonably amended by HMRC in any subsequent challenge thereto, provided the taxpayer is not unfairly disadvantaged: *Tower MCashback*.

Consideration and Conclusions

Preliminary point on the Scope of the Closure Notice

57. Mr Pettigrew raises a challenge concerning the scope of the Closure Notice. Although this point was raised fairly late in the proceedings, Mr Stone was able to deal with it and so I do not consider that HMRC have been unfairly disadvantaged. Mr Pettigrew highlights that the Closure Notice cross-refers the explanation provided by HMRC in the Complaint Letter, and the Complaint Letter refers to the definition of earnings in s 62(2)(b) ITEPA ("any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth") whereas, says Mr Pettigrew, HMRC's case now proceeds by reference to s 62(2)(c) ("anything else that constitutes an emolument of the employment"). Further, the Complaint Letter contended that the "interest-like payment" (£6,186.32) was taxable as miscellaneous income and not as employment income, whereas the Closure Notice assesses the whole of the Payment as employment income.

58. I can deal with the point concerning s 62 fairly briefly. The wording in the Closure Notice is: "The payment of the lump sum is therefore a payment of earnings within the meaning of section 62 of the Income Tax (Earnings and Pensions) Act 2003 and a tax liability arises accordingly." It is true that the Complaint Letter did highlight s 62(2)(b) but only in the context of a general argument concerning s 62 and emoluments from an employment. I conclude that the Closure Notice correctly and fairly states HMRC's conclusions as to why Mr Pettigrew's self-assessment return under enquiry required adjustment. Further, that has been HMRC's stance throughout the proceedings (see paragraphs 32-41 of HMRC's statement of case dated 25 April 2017 ("**the Statement of Case**")) and so Mr Pettigrew has been aware of that stance throughout the appeal.

59. Turning to the "interest-like payment" the situation is more complicated. In the Complaint Letter HMRC's view is explained thus:

> "In addition to the payment of arrears of £48,859.10, you also received an additional payment to compensate for the fact that your earnings were paid late. Your 18 November 2014 payslip shows this amount as 'Interest Payment £6,186.32'. This payment is not actually interest but is interest-like and calculated as if it were interest. It is taxable in principle as miscellaneous income in the year it is paid. It is not a payment of employment income and therefore was not subject to PAYE. The amount should have been paid gross to you and then you would have been required to declare the income and pay the appropriate tax due through your Self-Assessment return.
>
> I understand there was some confusion about these payments such that the MOJ incorrectly deducted tax under PAYE and paid the 'interest' amounts net to employees as they have in your case. The MOJ has now amended their approach to dealing with these 'interest' payments and will be paying them gross going forward."

60. The Closure Notice, although it refers to the explanation in the Complaint Letter, amends the return to include the entire Payment (ie including the "interest-like payment") as income from employment.

61. The position stated in the Statement of Case reverts (broadly) to that of the Complaint Letter:

> "42. The offer letter of 27 October 2014, stated that the total sum of £55,045.42 included "an interest like element of compensation". In the Appellant's payslip, the sum of £6,186.32 was described as an "interest payment".
>
> 43. That sum is chargeable to income tax under the miscellaneous income charging provisions in Part 5, Chapter 8 of [ITTOIA] (that is to say, s.687); alternatively as interest under Chapter 2, Part 4 of ITTOIA."

62. Mr Stone's skeleton argument (at paragraphs 71-74) added a further variation in that he summarised HMRC's case as being that the "interest-like payment" was an emolument of the employment, alternatively that it was interest taxable under s 369 ITTOIA. However, before me Mr Stone put HMRC's case on the same basis as stated in the Statement of Case.

63. I shall deal with the substantive issue in due course but the preliminary point raised by Mr Pettigrew is, can HMRC pursue their defence of his appeal in relation to this aspect on grounds other than those stated as HMRC's conclusion in the Closure Notice?

64. I have the benefit of the Supreme Court authority in *Tower MCashback* on this point. The Court scrutinised (*inter alia*) the view now put forward by Mr Pettigrew, that the subject matter of and conclusions in a closure notice must be strictly construed and not be expanded upon as a result of a taxpayer appeal against the notice. Lord Walker quoted with approval the words of Henderson J in the High Court:

> "[15] Henderson J … correctly observed, at [113]:
>
> > 'There is no express requirement that the officer must set out or state the reasons which have led him to his conclusions, and in the absence of an express requirement I can see no basis for implying any obligation to give reasons in the closure notice. What matters at this stage is the conclusion which the officer has reached upon completion of his investigation of the matters in dispute, not the process of reasoning by which he has reached those conclusions.'
>
> He also observed (again, in my view, entirely correctly), at [115]–[116]:
>
> > 'There is a venerable principle of tax law to the general effect that there is a public interest in taxpayers paying the correct amount of tax, and it is one of the duties of the commissioners in exercise of their statutory functions to have regard to that public interest. [The judge then considered changes in the tax system and continued] For present purposes, however, it is enough to say that the principle still has at least some residual vitality in the context of s 50, and if the commissioners are to fulfil their statutory duty under that section they must in my judgment be free in principle to entertain legal arguments which played no part in reaching the conclusions set out in the closure notice. Subject always to the requirements of fairness and proper case management, such fresh arguments may be advanced by either side, or may be introduced by the commissioners on their own initiative.
> >
> > That is not to say, however, that an appeal against a closure notice opens the door to a general roving inquiry into the relevant tax return. The scope and subject matter of the appeal

> will be defined by the conclusions stated in the closure notice and by the amendments (if any) made to the return.'"

65. Lord Walker cautioned (at [18]):

> **"**This should not be taken as an encouragement to officers of HMRC to draft every closure notice that they issue in wide and uninformative terms. In issuing a closure notice an officer is performing an important public function in which fairness to the taxpayer must be matched by a proper regard for the public interest in the recovery of the full amount of tax payable. In a case in which it is clear that only a single, specific point is in issue, that point should be identified in the closure notice. But if, as in the present case, the facts are complicated and have not been fully investigated, and if their analysis is controversial, the public interest may require the notice to be expressed in more general terms. As both Henderson J and the Court of Appeal observed, unfairness to the taxpayer can be avoided by proper case management during the course of the appeal. Similarly Dr Avery Jones observed in [*D'Arcy v RCC* [2006] STC (SCD) 543 (at [13])]:
>
> > 'It seems to me inherent in the appeal system that the tribunal must form its own view on the law without being restricted to what the Revenue state in their conclusion or the taxpayer states in the notice of appeal. It follows that either party can (and in practice frequently does) change their legal arguments. Clearly any such change of argument must not ambush the taxpayer and it is the job of the commissioners hearing the appeal to prevent this by case management.'"

66. In the subsequent case of *Fidex* the Upper Tribunal stated:

> **"[61]** There will be cases where a conclusion in a closure notice could be supported by more than one possible reason. That is unaffected by the new provisions. It is therefore quite possible that a reason for a conclusion other than those which originally motivated that conclusion may come to the fore during or after the review. Where this happens after the review it may make the review process, and the taxpayer's opportunity to make representations, otiose in the context of that new reason. The remedy, however, lies in the tribunal's case management powers, and in the obligation of the inspector to be helpful in his closure notice and to set out as precisely as possible his conclusions. We do not find that these new provisions cast much light on the issue before us in the present case.
>
> **[62]** In summary we derive the following principles from the legislation and case law to which we have referred:
>
> (1) An appeal to the FTT in such a case as this is brought against 'an amendment of a company's return' which is required to give effect to conclusions stated in a closure notice.

(2) The scope of the appeal is defined by and confined to the subject matter of the enquiry, the conclusions and amendments (if any) in the closure notice. An appeal does not permit HMRC to launch a new roving enquiry into a tax return.

(3) It is the HMRC officer's conclusions/amendments in the closure notice which matter, and not the process of reasoning which has led to them.

(4) The officer does not need to give reasons for his conclusions.

(5) The officer has a duty to make the closure notice as helpful to the taxpayer as is possible or appropriate in the circumstances.

(6) The FTT has jurisdiction to entertain legal arguments which have played no part in the officer's reasoning for the conclusions in the closure notice; any element of ambush or unfairness must be avoided by proper case management.

(7) It is a matter for the fact finding tribunal (the FTT) to identify the subject matter of the enquiry, the conclusions and, therefore, the appeal.

(8) In determining these matters the context is relevant and may include, in addition to the subject matter of the enquiry and the contents of the closure notice themselves, any other relevant correspondence.

(9) In making its determination the FTT should also balance protection of the taxpayer with the public interest in the collection of the correct amount of tax."

67. Taking all the above together my view is, as a result of the enquiry HMRC concluded that in order to collect the correct amount of tax it was necessary to adjust Mr Pettigrew's return to assess the Payment, including the amount of the "interest-like payment". That was effected by the Closure Notice. HMRC have since changed the legal argument on which they base that element of the adjustment – they now say it was miscellaneous income, or alternatively interest income, rather than income from employment. Such a change of legal argument is permitted (per *Tower MCashback* and *Fidex*) provided the change does not ambush or unfairly prejudice Mr Pettigrew. HMRC's current argument has been plain since the Statement of Case was served and Mr Pettigrew was able to deal with it at the hearing. For those reasons I do not consider there is any objection to HMRC pursuing their defence of the appeal on the basis of the legal arguments set out in the Statement of Case and argued in the hearing before me.

Preliminary Issue on the Burden of Proof

68. For completeness, the burden of proof in this appeal lies on Mr Pettigrew. The passage to the contrary he cited from *Hochstrasser* (Viscount Simonds at 389) has been superseded by the statutory provision in s 50(6) TMA 1970. I should add that in my determination of this appeal nothing turned on this point

The main issue: Whether the Payment was an emolument of employment

69. The statutory question is whether the Payment "constitutes an emolument of the employment". As recently stated by Lord Hodge in *Rangers* (at [15]):

> "In summary, three aspects of statutory interpretation are important in determining this appeal. First, the tax code is not a seamless garment. As a result provisions imposing specific tax charges do not necessarily militate against the existence of a more general charge to tax which may have priority over and supersede or qualify the specific charge. … Secondly, it is necessary to pay close attention to the statutory wording and not be distracted by judicial glosses which have enabled the courts properly to apply the statutory words in other factual contexts. Thirdly, the courts must now adopt a purposive approach to the interpretation of the taxing provisions and identify and analyse the relevant facts accordingly."

Analysis of the facts

70. My analysis of the relevant facts in this case is as follows.

(1) Mr Pettigrew filed an Employment Tribunal claim against MoJ, which (so far as relevant to this tax appeal) was stayed behind the lead case of *Miller*. That claim was settled by agreement, resulting in the Payment.

(2) Mr Pettigrew's statement of claim to the Employment Tribunal stated in relation to sitting fees, "The Claimants claim the difference between the payments actually received over the periods of their appointment and the payments they should have received if the divisor of 220 had been applied together with interest"; and in relation to training fees, "compensation equivalent to the difference between the full payment received by a fee-paid employment judge and that which he received for judicial training".

(3) The terms of possible settlement were put forward in the 2014 Statement where MoJ in effect accepted that there had been less favourable treatment without objective justification, and a resulting "underpayment of daily fees" and other "past losses". The 2014 Statement invited submissions of claims for particularised losses.

(4) Mr Pettigrew submitted his particularised "claim for underpayment of training fees and daily rates for sitting and other work as a Fee-paid [employment judge]" with a spreadsheet detailing a "shortfall calculation". The spreadsheet details the number of days sitting or training in each period, and gives figures for "training fee underpaid" and "sitting fee underpaid" for each period and in total.

(5) The settlement offer was contained in the MoJ Offer Letter, which details several elements for which compensation is offered. For training days, the offer is because, "As you were incorrectly paid a half day fee for those dates, when you should have been paid a full days fee, the offer

contains the balance between what you were paid and what you should have been paid for each year." For sitting days, the offer is because, "fee paid Employment Tribunal Judges were underpaid in relation to the salaries of salaried Employment Tribunal Judges", and "As you were incorrectly paid a half day fee for those dates, when you should have been paid a full days fee, the offer contains the balance between what you were paid and what you should have been paid for each year." For London weighting, the offer is because, "Fee paid judges are eligible to a pro rata amount of London Weighting based on the number of sittings you sat, and only for the years where you sat at eligible courts." Adding together all those elements, MoJ makes an offer of, "the difference in the amount you were actually paid and the amount that you should have been paid as a fee paid Employment Tribunal Judge each year, which amounts to £55,045.42."

(6) Mr Pettigrew accepted that offer and accordingly received the Payment.

(7) The Payment was made and accepted in full and final settlement of Mr Pettigrew's claim, following the decision adverse to MoJ in *Miller*. That litigation concluded there had been a breach of the PTWR in that fee-paid judges had been treated less favourably than comparable full-time judges because they were part-time, and without objective justification for that treatment. The exact nature of the right that was infringed is set out in reg 5 PTWR:

> "*Less favourable treatment of part-time workers*
>
> (1) A part-time worker has the right not to be treated by his employer less favourably than the employer treats a comparable full-time worker—
>
> (a) as regards the terms of his contract; or
>
> (b) by being subjected to any other detriment by any act, or deliberate failure to act, of his employer.
>
> (2) The right conferred by paragraph (1) applies only if—
>
> (a) the treatment is on the ground that the worker is a part-time worker, and
>
> (b) the treatment is not justified on objective grounds. …"

(8) The issues in *Miller* that are relevant to this tax appeal were included in "a wide range of issues concerning various elements of the remuneration of salaried judicial office holders which are not replicated in, or are said to be less favourable in, the terms and conditions of fee paid judges" (para 1 of *Miller*). In relation to sitting fees it was found (indeed, seems to have been agreed) that fee paid tribunal judges should receive a

daily fee of 1/220th of the annual salary of a salaried tribunal judge (rather than the lower daily sitting fee paid by MoJ): "Following the *O'Brien* preliminary hearing the claimants were asked to specify the daily divisor for which they contended in respect of each category of judge and the respondent was asked to indicate whether it took the same point or different points in defending those contentions. The area of dispute turned out to be relatively narrow as the claimants accepted that 220 was the correct divisor for all tribunal judges." (para 63). In relation to training fees it was found that differential fees for fee-paid judges constituted unjustified less favourable treatment: "I start from the premise that it is now not seriously disputed that to pay two judges who attend the same training course different amounts is less favourable treatment of the one who is paid less. If it is, it ought not to be and I shall waste no time dealing with the point." (para 104). On London weighting it was found that denying payment to fee-paid judges also constituted unjustified less favourable treatment: "It follows that a fee paid judge who satisfies the eligibility conditions for London weighting with regard to their principle [*sic*] place of work, is treated less favourably than their full time salaried comparator in the matter of London weighting which treatment cannot be objectively justified." (para 154). A declaration of rights was made (sch 2, and see reg 8(7)(a)); there is no express calculation of compensation and that was presumably left for the parties to discuss.

(9) Reading the *Miller* judgement as a whole I consider it is clear that the Employment Tribunal considered the infringement was "as regards the terms of his contract" (reg 5(1)(a)). On the three relevant items (sitting and training fees and London weighting) there is no suggestion that the Employment Tribunal considered a fee-paid judge was "being subjected to *any other* detriment by any act, or deliberate failure to act, of his employer" (emphasis added) (reg 5(1)(b)). It was simply that the contracts of fee-paid judges provided for lower sitting and training fees and no London weighting, and that constituted unjustified less favourable treatment. That analysis is also supported by the terms of the MoJ Offer Letter which set out the grounds on which the Payment was offered and accepted – see (5) above.

(10) This is all entirely in accord with the remedy provisions in reg 8 PTWR (quoted at [25] above). Mr Pettigrew settled his claim but had he pursued it then he would have asked the Employment Tribunal to "[order] the employer to pay compensation to the complainant" (per reg 8(7)(b)); he (legitimately) sought financial compensation for his unjustified less favourable treatment. I would also note that reg 8(11) specifically excludes from compensation under reg 5 any "compensation for any injury to feelings".

71. From the above analysis I find that the Payment was an agreed full-and-final settlement of Mr Pettigrew's claim against MoJ and represented fees (including an element of London weighting) underpaid for sitting and training days in the relevant

periods. Mr Pettigrew's particularised claim describes the amount claimed as a "shortfall" and "fee[s] underpaid". The MoJ Offer Letter is clear that the amounts offered represent underpayments being "the balance between what you were paid and what you should have been paid for each year." Mr Pettigrew accepted that offer on the stated terms – although I understand Mr Pettigrew not to be making this contention I should add that I consider where a person accepts unconditionally an offer made in clear terms then they (at least, if professionally legally advised on the terms of settlement) cannot subsequently seek to recharacterise the basis of that offer unilaterally.

Principles from Caselaw relevant to the current appeal

72. In relation to a purposive interpretation of the legislation, Lord Hodge in *Rangers* stated:

> "*(i) Interpreting the legislation*
>
> [35] Income tax on emoluments or earnings is, principally but not exclusively, a tax on the payment of money by an employer to an employee as a reward for his or her work as an employee. As we have seen from the use of the word 'therefrom' in s 19 of ICTA (para [5], above), income tax under Sch E was charged on emoluments from employment. In other words, it was a tax on the remuneration which an employer pays to its employee in return for his or her services as an employee. This concept also underpins the concept of 'earnings' in ITEPA (para [6], above) which in s 9(2) refers to 'taxable earnings from an employment' and in s 62 defines earnings in relation to an employment. Included in that definition in s 62(2)(c) is the catch-all phrase: 'anything else that constitutes an emolument of the employment'. That which was an emolument under prior legislation remains an emolument under ITEPA. What is taxable is the remuneration or reward for services: *Brumby (Inspector of Taxes) v Milner, Day (Inspector of Taxes) v Quick* [1975] STC 644 at 649–650, [1976] 1 WLR 29 at 35 per Lord Russell of Killowen in the Court of Appeal; [1976] STC 534 at 536, [1976] 1 WLR 1096 at 1098–1099 per Lord Wilberforce in the House of Lords. That is not in dispute."

73. The extensive caselaw which both parties (absolutely correctly) cited to me is (to use Lord Hodge's words) the "judicial glosses which have enabled the courts properly to apply the statutory words in other factual contexts." Nevertheless, various principles have been established in that caselaw which I must respect - see Patten LJ in *Kuene + Nagel* (at [51]): "The ways in which that necessary link has been described and analysed in the earlier cases does, I think, have to be respected even though the ultimate question is whether the 'from' question can be answered in the affirmative."

74. The principles established by the caselaw which I consider relevant to the current appeal are as follows.

75. A payment can be an emolument even though there is no contractual entitlement thereto. In *Laidler* a company gave £10 vouchers to many of its staff every Christmas. Lord Morris stated (at p 33):

> "My Lords, in respect of his employment the appellant was chargeable to tax on emoluments therefrom. In addition to his salary and to his bonuses he received in each of the years in question a voucher which was worth £10. I cannot doubt that those vouchers were emoluments within the definition of that expression. That being so, they were chargeable to tax if they were emoluments from his employment. While it is clear that the appellant would not have received the vouchers had he not been a staff employee, the facts as found show that he only received the vouchers because he was a staff employee. He received them only in his capacity as a staff employee. The reason why the vouchers were distributed was that the directors wished to maintain a feeling of happiness among the staff and to foster a spirit of personal relationship between the management and staff. The directors believed that a contented staff was "a good thing in itself and likely to be of advantage to the group." The case finds that the "policy" of providing Christmas presents to the staff was followed as "one of several measures" to help to maintain and to foster the desired feelings of happiness and content. Christmas gave the occasion for the distribution of the vouchers, but on the facts as found the reasons for the distribution are to be found in the employer-employee relationship. The vouchers were not distributed to the staff workers on any individual or personal grounds nor were there any special or particular reasons which were peculiar to any of them. Though the impulses of generosity and of kindly and seasonal goodwill were not lacking, the facts as found show that there was manifested that form of gratitude which is "a lively sense of future favours." The directors were planning for good and loyal future service so that the company would prosper and be advantaged. In the result the vouchers were distributed by the employers in their capacity as employers and because they were employers: they were received by the employees in their capacity as employees and because they were employees. In these circumstances the emoluments were from the employment."

76. A payment of compensation for loss of rights directly connected with an employment will generally be an emolument of that employment. In *Hamblett v Godfrey* the employment terms of civil servants at GCHQ were unilaterally varied by the employer to deny certain rights under employment legislation, including the freedom to join a union (other than a designated staff association); any staff objecting were transferred elsewhere in the civil service; those consenting were paid £1,000 each in recognition of their loss of rights. Purchas LJ stated (at p 68):

> "So, in my judgment, the approach that the court should take … is to consider the status of the payment and the context in which it was made. The payment was made to recognise the loss of rights. …
>
> The rights, the loss of which was being recognised, were rights under the employment protection legislation, and the right to join a union or

> other trade protection association. Both those rights, in my judgment, are directly connected with the fact of the taxpayer's employment. If the employment did not exist, there would be no need for the rights in the particular context in which the taxpayer found herself. So, I start from the position that those are rights directly connected with employment. Purely by way of contrast, to underline that approach, if for instance the employers had for some reason or other best known to themselves objected to some social or other activity which their employees or some of them enjoyed, such as joining a golf club or something of that sort (I think Lord Diplock mentioned payments in the hunting field), but whatever it is, activities not connected with the employment, then a payment made by an employer to recognise the voluntary or, indeed, the compulsory withdrawal if the employer had sufficient influence with the committee of the golf club concerned, then that I can readily acknowledge would be a payment made to a person who was an employee but was not made in the circumstances which would satisfy the words of s 181; that is that the payment must arise 'therefrom'. I only mention that analogy to emphasise the point which I seek to make.
>
> There is no doubt in this case that the employment protection legislation goes directly to the employment of the taxpayer with the employer. The right to join a union, in my judgment, also falls directly to be considered as in connection with that employment, because without the employment there is no purpose in joining the union except for esoteric or personal reasons which are not relevant in this case. But I can again see a situation in which persons involved in particularly sensitive areas of government service might be required to abandon their right of freedom of speech. In such a case, it would clearly have to be considered on the facts involved in the individual case to see whether the abandonment of that fundamental right was in fact connected and arose on the employment or not, and it would clearly differ from case to case.
>
> … This payment is rightly to be assessed under Sch E …"

77. A payment made to satisfy a contingent right to another payment will generally derive its character from the nature of the payment which it replaces. In *Mairs v Haughey* employees of the (state owned) Harland & Wolff shipyard enjoyed a generous non-statutory enhanced redundancy scheme; on privatisation of the shipyard that scheme ended and employees received an "*ex gratia* payment" in amounts negotiated with the relevant unions. Lord Woolf stated (at p577):

> "It is inevitable that if a payment is made in substitution for a payment, which might, subject to a contingency, have been payable that the nature of the payment which is made in lieu will be affected by the nature of the payment which might otherwise have been made. There will usually be no legitimate reason for treating the two payments in a different way."

78. The character for tax purposes of a receipt of compensation for failure to make a payment due, should be the same as that of the payment if it had been paid. The

leading authority on this point is *London & Thames Haven* which concerns a receipt taxable as a trading profit, but the principle expressed by the Court of Appeal is not limited to taxation of trading profits. Diplock LJ stated (at 815):

> "Where, pursuant to a legal right, a trader receives from another person compensation for the trader's failure to receive a sum of money which, if it had been received, would have been credited to the amount of profits (if any) arising in any year from the trade carried on by him at the time when the compensation is so received, the compensation is to be treated for income tax purposes in the same way as that sum of money would have been treated if it had been received instead of the compensation. The rule is applicable whatever the source of the legal right of the trader to recover the compensation. It may arise from a primary obligation under a contract, such as a contract of insurance, from a secondary obligation arising out of non-performance of a contract, such as a right to damages, either liquidated, as under the demurrage clause in a charter-party, or unliquidated, from an obligation to pay damages for tort, as in the present case, from a statutory obligation, or in any other way in which legal obligations arise."

79. Where there is more than one reason for the payment then the employment must be a sufficiently substantial reason for the payment to characterise it as an emolument of the employment. That is a paraphrase of Etherton LJ's statement (at [60]) in *Kuehne + Nagel*, and Patten LJ stated (at [56]): "Employment does not have to be the sole cause but it does have to be sufficiently substantial as to characterise the payment as one from employment."

Mr Pettigrew's contentions

80. Mr Pettigrew contends that the Payment represents not taxable earnings but instead compensation for a statutory tort, pursuant to the PTWR. As already stated, it is well-established that a payment of compensation (whether by order of a court in judgment or by settlement or compromise of litigation) can constitute earnings for tax purposes. The question must still be asked, whether the Payment constitutes an emolument of the employment.

81. Mr Pettigrew highlights that MoJ limited the settlement offer to judges who had filed in-time claims at the Employment Tribunal; judges who were too late to file claims were not recompensed for the discriminatory treatment suffered by them. Therefore, says Mr Pettigrew, the payments cannot be characterised as remuneration for past services, as under that characterisation MoJ would be paying all judges, not only those who commenced Employment Tribunal proceedings by the procedural deadline. I do not consider this point assists Mr Pettigrew; any legal remedy which is subject to a time limit for claim may leave some potential litigants time-barred but that does not change the character of the remedy received by any successful in-time litigants.

82. Mr Pettigrew fairly accepts that in the extensive caselaw there are instances where lump sum payments as compensation were held to be taxable as employment income. However he highlights in particular three cases which he says bear close resemblance

to his facts (payment of a sum in settlement of Employment Tribunal proceedings) and where the payment was held not to constitute an emolument of the employment: the Court of Appeal decision in *Wilson v Clayton* and the First-tier Tribunal cases of *Oti-Obihara* and *A v HMRC*.

83. Before addressing those cases I raise a caution. Two of the cases relate to terminations of employments; payments in such circumstances (typically statutory or non-statutory redundancy pay) are not emoluments of the employment (because the employment has ended and so there is no continuing employment source for the payment) unless made pursuant to the terms of the former employment (even though paid after termination thereof) (see eg *EMI Group Electronics Ltd v Caldicott* [1999] STC 803). Such a payment thus either, under historical legislation, escapes taxation entirely or, since the 1960s, is taxed only by virtue of specific statutory provision to that effect (and then only to the extent it exceeds a stated *de minimis* threshold): see now ss 401 *et seq* ITEPA. The point I wish to emphasise on these termination cases is that a conclusion by the relevant court that a particular payment was not taxable, is not *in itself* indicative that a similar set of facts but relating to a non-termination situation should give rise to the same result.

84. That caution applies particularly to the first case, *Wilson v Clayton*. Certain employees of Birmingham City Council were entitled to a car user allowance; the Council decided to scrap the allowance and any employees who did not consent (including Mr Clayton) were dismissed and immediately re-employed on terms which excluded the allowance; Mr Clayton (unsurprisingly) complained to the Employment Tribunal which (also unsurprisingly) found he had been unfairly dismissed; the parties agreed a remedy order including reinstatement of the allowance and a payment of compensation. The Court of Appeal held that the compensation was not an emolument from the employment because the employment had ended when Mr Clayton was dismissed, and the payment was compensation for that unfair dismissal; in particular, the provision in the employment legislation requiring treatment of unbroken continuity of service did not change the reality that the old employment had ceased; the payment was, however, taxable as a payment in connection with termination of employment (under the precursor provisions to s 401 *et seq* ITEPA) but did not exceed the £30,000 *de minimis* threshold. Peter Gibson LJ stated (at [39]):

> "I ask myself the simple question: is the payment an emolument … from the employment? The answer I give unhesitatingly is that it is not. It is not enough that Mr Clayton would not have received it but for having been an employee. It is not a payment in return or as a reward for past services. It is not a payment in return for acting as or being an employee. It is not a payment as an inducement to enter into employment—he already was employed—or to provide future services. If one looks for what reason it was paid, the answer is obvious from para 1(b) of the consent order: it was to compensate Mr Clayton for the unfair dismissal. As it was paid, and paid by way of settlement of his claim, it is irrelevant that objection might have been taken to the agreement evidenced by the consent order or to the order itself. I conclude that the Crown's argument based on s 19 [ICTA 1970, taxing emoluments from employment] must be rejected."

85. I am not sure that *Wilson v Clayton* assists where compensation is paid to a continuing employee (that is to say, one who continues in fact rather than by a statutory deeming provision). Peter Gibson LJ stated (at [33]):

> "Indeed the entire proceedings were based on the claim, upheld by the ET at the liability hearing, that the employees had been unfairly dismissed. Nor is it artificial to treat the dismissal as having occurred. The Council, in the absence of the agreement of the employees, could not change the terms of employment so as to take away their contractual right to [the allowance]. That is why the Council terminated their contracts of employment and offered new contracts which did not contain that right."

86. It seems to me that if Mr Clayton had received the payment while he was still (in fact) employed by the Council then the position is closer to that in *Hamblett v Godfrey*, which I shall come to later.

87. The other termination of employment case is the First-tier Tribunal case of *Oti-Obihara*. Mr Oti-Obihara was employed in London by a US company, alleged he suffered racial insults, and commenced Employment Tribunal proceedings claiming racial discrimination; the litigation was settled (without admission of liability) by a payment of £500,000. The Tax Tribunal found that the payment had two elements: £165,000 as compensation for loss of office (taxable under s 401 ITEPA except for the first £30,000), and £335,000 "damages or other compensation for infringement of rights which do not represent financial loss arising from the termination" (at [35]). HMRC had accepted (see [18]) "that, to the extent that any part of the Settlement Payment comprised damages for injury to the Appellant's feelings as a consequence of discrimination, then that is not taxable under section 6 ITEPA 2003, nor is it taxable under section 401 ITEPA as a termination payment even if it is paid on the occasion of the termination of the employment contract.". On the second element the Tribunal commented (at [48]):

> "That might be seen as a large amount by way of settlement for non-pecuniary loss as a result of alleged discrimination and harassment. However, this case has to be seen in its particular and untypical circumstances. For the reasons I have already given, namely the Appellant's likely rights under United States legislation and the employer's likely concerns as to its reputation and privacy in a matter such as this … a settlement payment out of the ordinary magnitude (at least in a purely UK context) might not be quite so surprising. In support of that view I note the evidence to the effect that compensation of an amount equating to the whole of the Settlement Payment was discussed in general terms with the Appellant in relation to his claims when both parties were contemplating that his employment would continue. I also note Morgan Stanley's email summary of the matter given to the Appellant in his preparation for this appeal …: too much weight should not be attached to what was likely to have been a quick and brief email reply, but it is perhaps indicative of the significance which Morgan Stanley attached to the situation that they refer to the

> Appellant's claim for racial discrimination rather than to his claim for constructive dismissal."

88. However, in *Moorthy* the Upper Tribunal stated (at [38]):

> "The existence of a claim for discrimination may be relevant if the discrimination is unconnected with the termination of employment but it does not change the question to be addressed. In our view, the question remains is there the necessary connection between the payment and the termination of employment? The issue does not become whether the payment is compensation for financial loss caused by termination merely because other claims, such as for discrimination, may have been included in the settlement. We consider that, when determining whether a payment received in connection with the termination of employment falls within s 401 ITEPA there is no distinction between non-pecuniary aspects of the award, such as injury to feelings, and pecuniary aspects such as financial loss. In our view, *Oti-Obihara* was wrong on this point and should not be followed."

89. After the hearing of the current appeal the Court of Appeal issued its decision in the onward appeal in *Moorthy*: [2018] EWCA Civ 847. Having reviewed that case I decided that it was not necessary to invite further representations from the parties, as the only part of the Court of Appeal decision relevant to the current appeal is the confirmation that the Upper Tribunal was right to disapprove *Oti-Obihara* – per Henderson LJ (at [43]):

> "The Upper Tribunal reviewed the case law on the taxability issue at [25] to [42] of the UT Decision. For reasons which I need not elaborate, they convincingly explained why certain earlier decisions at Special Commissioner or FTT level had been mistaken in so far as they held, or appeared to hold, that amounts paid in connection with the termination of employment fall within the scope of section 401 only to the extent that they represent compensation for financial losses. The most influential of those cases was *Oti-Obihara v HMRC* [2010] UKFTT 568 (TC), [2011] IRLR 386, where the FTT had concluded that £165,000 of the £500,000 settlement payment received by Mr Oti-Obihara represented financial losses caused by the termination of his employment by a US investment bank in London, but the balance was attributable to non-pecuniary loss (notably his claim for racial discrimination) and was not taxable. As the Upper Tribunal pointed out at [38], this approach could not be supported because it ignored the clear statutory wording of section 401. The relevant question is always whether there is "the necessary connection between the payment and the termination of employment"."

90. The last case – and the one on which Mr Pettigrew places especial weight - is *A v HMRC*. I can adopt the summary given by the Upper Tribunal in *Moorthy*:

> "[40] The case of *A [2015]* concerned a race discrimination claim brought by an employee, A, against his employer, a bank. A worked as a trader in the bank from 2003. He believed that, between 2004 and

2007, he was treated less favourably than other employees in relation to salary and annual bonuses because of his race. In November 2007, A wrote to the bank setting out his grievances. At that time, redundancies were imminent because the bank had been acquired by a larger bank. The grievances were investigated but not resolved to A's satisfaction. In March 2008, A's solicitor served a questionnaire in relation to race discrimination under the former statutory procedure. Some two weeks later, the bank told A that he was to be made redundant. The bank offered A statutory redundancy pay of £1,650, an ex-gratia redundancy payment of £48,898 and an additional lump sum of £600,000 in settlement of all outstanding and potential claims. A accepted and signed a settlement agreement.

[41] HMRC took the view that the £600,000 payment was taxable as earnings within s 62 ITEPA and amended A's self-assessment tax return for 2008/09. A appealed to the FTT on the ground that the sum was compensation in respect of his threatened race discrimination claim. At paras [59] and [60] of *A [2015]*, the FTT observed that issue was a narrow one of whether the settlement payment of £600,000 compensation to settle a threatened race discrimination claim was taxable as 'earnings' within s 62 ITEPA. The FTT held that it was not.

[42] The FTT noted that 'HMRC do not make any argument that the payment is in any way "in connection with" the appellant's termination of employment so as to fall within the provisions of s 401 ITEPA' as HMRC agreed that the payment to A did not fall within the section. It is not clear why HMRC did not seek to argue that s 401 applied in *A [2015]*. It may be because, as the FTT in that case noted at para [60], it was common ground that the £600,000 payment related to alleged discriminatory treatment during the course of A's employment. For that reason, we consider that the decision in *A [2015]* provides little, if any, assistance in determining the issues in this case. We note that the FTT in *A [2015]* did not regard *Walker* or *Oti-Obihara* as relevant to the question of how to interpret s 62."

91. Mr Pettigrew particularly relies on the following passage in *A v HMRC*:

"81. If an Employment Tribunal were to award damages for discrimination (whether calculated by reference to earnings or whether they included injury to feelings) these are recompense for the right not to be discriminated against under statute. They are paid because the employer has breached a statutory obligation not to treat the employee in a detrimental way due to his race. They are treated in like manner to a tort claim. It could be said that where the complaint is of underpayment of remuneration that the damages would not have arisen if were not for the fact the claimant was an employee but it is clear that it is not enough. That sort of wide test of causation (a "but for" test) is insufficient (see *Hochstrasse* [*sic*] *v Mayes*). When we pose the question: "Why did the employee receive the payment?" the answer is not that it was in return for the employee's services but because it has been determined that the employer has acted unlawfully by discriminating against the employee. Where damages are calculated by

> reference to under-paid earnings, while the discrimination may have manifested itself through the way in which the employee was remunerated, the damages arise not because the employee was under remunerated but because the under payment was discriminatory. An award in these circumstances cannot in our view be described as a reward for services. The award is paid for some reason other than the employment and is not earnings. (The extent to which the non-taxability of the damages is taken account of in determining the amount of the compensation award would of course be a matter for the Employment Tribunal making the award to determine in accordance with the relevant law.)"

92. The Upper Tribunal in *Moorthy* commented:

> **"[55]** We acknowledge that … there appears to be an anomalous distinction between payments of compensation for discrimination before termination, which in *A* [*2015*] were held not to be taxable as earnings under s 62 ITEPA, and such compensation paid in connection with termination which, on our view of s 401, counts as earnings. However, in our judgment, that is a consequence of such payment being deemed to be earnings by s 401. It is true that this may require an amount of compensation to be apportioned between events which occurred before and after termination so that they can be treated differently for tax purposes. But we do not consider that such apportionment would be impossible or excessively difficult. The need to carry out such an exercise does not, in our judgment, compel a different construction of the words of s 401, which are clear."

93. In the onward appeal in *Moorthy* the Court of Appeal did not cite *A v HMRC*.

94. As a First-tier Tribunal decision *A v HMRC* is not a binding authority. I note that:

> (1) The Tribunal observed (at [73-74]) that there was no authority cited to it that supported the contentions of either party concerning the question "whether compensation in respect of underpaid salary and bonus due to discrimination is subject to tax under s62 ITEPA".
>
> (2) The Tribunal did not appear to have been cited and therefore did not have the benefit of the analysis of the Court of Appeal in *Kuehne + Nagel* – in particular the statement that for a payment to be an emolument of the employment it need not be the sole cause of the payment but only be "sufficiently substantial" (see [79] above).
>
> (3) Similarly, the Tribunal did not appear to have been cited and therefore did not have the benefit of the analysis of the House of Lords in *Mairs v Haughey* – in particular the statement that a substitution payment will usually take its taxable character from that of the payment for which it substitutes (see [77] above).

(4) In the textbook referred to by Mr Stone – *Harvey on Industrial Relations and Employment Law* – the authors note (at [71]) that "The decision … may be regarded as peculiarly fact-sensitive."

95. Having carefully considered *A v HMRC* I have decided, for the above reasons, that it does not assist me in determining the current appeal.

96. Finally in relation to Mr Pettigrew's contentions, he drew my attention to the HMRC guidance in the Employment Income Manual (at EIM 2965). He accepts that has no legal force in relation to proceedings before this Tribunal. As it was quoted to me, I would comment that it specifically relates to payments on termination of employment (and thus their taxability under s 401 ITEPA) and it concentrates on "compensation for hurt feelings". This was, I presume, the basis of the concession made by HMRC in *Oti-Obihara* that "damages for injury to the Appellant's feelings as a consequence of discrimination [were] not taxable under section 6 ITEPA 2003" (see [87] above). I would also highlight that reg 8(11) of the PTWR specifically excludes any compensation for injury to feelings. Therefore, I do not consider that any part of HMRC's stance on Mr Pettigrew's appeal runs contrary to their guidance in the Manual.

Applying the principles to the facts as found.

97. First, the fact that the Payment related to sums not provided for in Mr Pettigrew's contractual terms and conditions does not (in itself) prevent the Payment being an emolument of the employment: *Laidler* (see [75] above). In Mr Pettigrew's contract there was provision for sitting and training fees but at rates lower than enjoyed by salaried judges; there was no provision for London weighting and the principle in *Laidler* attaches to that part of the Payment.

98. Secondly, the fact that the Payment was received as a lump sum in settlement of litigation does not (in itself) prevent the Payment being an emolument of the employment: *London & Thames Haven* (see [78] above). Indeed, Diplock LJ stated, "the compensation is to be treated for income tax purposes in the same way as that sum of money would have been treated if it had been received instead of the compensation." That is supported by *Mairs v Haughey* (see [77] above) where Lord Woolf stated, "It is inevitable that if a payment is made in substitution for a payment, which might, subject to a contingency, have been payable that the nature of the payment which is made in lieu will be affected by the nature of the payment which might otherwise have been made. There will usually be no legitimate reason for treating the two payments in a different way."

99. Thirdly, even though the prompt for MoJ to make the Payment was the settlement of claims stood behind the *Miller* litigation, the methodology and quantification of the Payment was to remedy the underpayments in the period April 2010 to December 2013 under the contract of employment; there was a simple calculation of differences between what Mr Pettigrew was actually paid at the time and what a salaried judge comparator would have earned for the same duties performed. I agree with Mr Stone's comment that Mr Pettigrew had concentrated on the mechanism for the

Payment rather than the reason for it being paid. Even if the *Miller* litigation was one reason for the Payment, that does not displace the employment relationship also being another reason; one would then apply the test in *Kuehne + Nagel*: was the employment a sufficiently substantial reason for the payment? For the reasons set out at [70-71] above, I am sure that the employment *was* a sufficiently substantial reason for the Payment.

100. Finally, I consider the matter in dispute in the current appeal is firmly settled by the Court of Appeal decision in *Hamblett v Godfrey*. *Hamblett* directly concerned a payment in relation to statutory employment rights. It is true that in *Hamblett* the compensation was for relevant rights being given up rather than being breached, but the Court of Appeal was clear that the nature of the statutory rights was directly connected with the employment: per Purchas LJ "The rights, the loss of which was being recognised, were rights under the employment protection legislation, and the right to join a union or other trade protection association. Both those rights, in my judgment, are directly connected with the fact of the taxpayer's employment. If the employment did not exist, there would be no need for the rights in the particular context in which the taxpayer found herself. So, I start from the position that those are rights directly connected with employment." Moreover, Neill LJ dealt specifically with the point raised here by Mr Pettigrew, that the PTWD rights breached by MoJ were personal rights enjoyed by Mr Pettigrew distinct from the employment relationship (at 70):

> "But in the end I think it is right to base my decision on the wording of the statute. It is clearly not enough that the payment was received from the employer. The question is, was the payment an emolument from the employment? In other words, was the employment the source of the emolument? It was argued by counsel for the taxpayer in the course of his cogent submissions that the rights lost by the taxpayer were mere personal rights, and that indeed, this was a stronger case from the taxpayer's point of view than the *Hochstrasser* case since the rights given to the employee in that case were part of a composite contract. With respect, I find it impossible to accept this argument. As the Special Commissioners held, the rights had been enjoyed within the employer/employee relationship. The removal of the rights involved changes in the conditions of service. The payment was in recognition of the changes in the conditions of service.
>
> I have been driven to the conclusion that the source of the payment was the employment. It was paid because of the employment and because of the changes in the conditions of employment and for no other reason. It was referrable to the employment and to nothing else. Accordingly, in my judgment, the £1,000 was a taxable emolument."

101. Applying those principles to the analysis of the facts as found, I conclude that the Payment (apart from the "interest-like payment" element which I consider next) does constitute an emolument of Mr Pettigrew's employment with MoJ.

The "interest-like payment"

102. As stated at [67] above I decide this point by reference to the argument put forward by HMRC in their Statement of Case: "That sum is chargeable to income tax under the miscellaneous income charging provisions in Part 5, Chapter 8 of [ITTOIA] (that is to say, s.687); alternatively as interest under Chapter 2, Part 4 of ITTOIA."

103. The interest-like payment is described in the MoJ Offer Letter thus: "an interest like element of compensation has been included in this sum based on the Preston index rate, which is the method of interest that has been agreed with the claimant solicitors in the Employment Tribunal Litigation." I understand this is a reference to the leading part-time workers litigation conducted *sub nom Preston & others v Wolverhampton NHS Trust & others*. The Preston index rate is described by HM Treasury as follows (https://www.gov.uk/government/collections/preston-guidance):

> "Following the European Court of Justice and House of Lords' rulings in 2000/2001 in favour of part-timers gaining retrospective access to occupational pension schemes, provided they meet the necessary legal requirements, the Preston factors (Earnings and Interest factors) are provided for employers. The factors are used to provide those entitled to reinstatement, an opportunity to gain pension service at no cost to them, which as far as possible makes these individuals no better and no worse off than if they had paid contributions to the scheme when they were originally employed."

104. I conclude that the interest-like payment was made to ensure that as far as possible Mr Pettigrew was no better and no worse off than if he had received the disputed earnings when he worked the sitting and training days to which the earnings relate. Thus I agree with the description given in the Complaint Letter: "In addition to the payment of arrears of £48,859.10, you also received an additional payment to compensate for the fact that your earnings were paid late."

105. The House of Lords in *Riches* determined that a sum of money awarded by a court as interest and included in the total sum for which judgment was given was interest for tax purposes. After the hearing of the current appeal the Court of Appeal issued its decision in *RCC v Lomas* [2018] STC 385, giving an extensive review of the caselaw relating to the tax treatment of interest – in particular the nature of "yearly interest" in a tax context. Having reviewed that case I decided that it was not necessary to invite further representations from the parties, as nothing therein qualifies *Riches*; indeed, I can adopt the summary of *Riches* given by Patten LJ in *Lomas*:

> "[21] … It is therefore common ground on this appeal that statutory interest is 'interest' within the meaning of s 874 and that the administrators' argument that it is not 'yearly interest' turns on the meaning and effect of the word 'yearly'. The point is in any event concluded by authority because in *Riches v Westminster Bank Ltd* [1947] 1 All ER 469, [1947] AC 390 the House of Lords decided that a sum of money awarded as interest under s 3(1) of the Law Reform

(Miscellaneous Provisions) Act 1934 (now re-enacted as s 35A SCA 1981) as part of a judgment sum was 'interest of money' within Sch D of the Income Tax Act 1918 so as to be payable under deduction of tax under r 21 of the All Schedules Rules of the Act.

[22] The argument for the taxpayer in *Riches* was that the sum awarded by way of statutory interest under the 1934 Act was in reality damages for the wrongful detention of the money. The judgment had been obtained in proceedings for an account of the profits made by the deceased defendant from a sale of shares which he was contractually obliged to pay to the judgment creditor. That argument derived some support from an obiter dictum statement of Wright J in *Re National Bank of Wales Ltd* [1899] 2 Ch 629 at 651 but it was rejected by the House of Lords. The analysis in the speeches in the Appellate Committee is instructive and I will return to them later in this judgment when I come to the question of what constitutes 'yearly' interest. For the moment, however, the following extracts explain why a compensating payment could nonetheless be 'interest of money' for the purposes of Sch D.

[23] Viscount Simon dealt with the point ([1947] 1 All ER 469 at 471, [1947] AC 390 at 398):

> 'Counsel for the appellant advanced a further argument that the added sum was not in the nature of "interest" in the sense of that expression in the Income Tax Acts because the added sum only came into existence when the judgment was given and from that moment had no accretions under the order awarding it. (Interest on a judgment debt is, of course, a separate matter and counsel did not challenge the view that this latter interest was subject to tax). But I see no reason why, when the judge orders payment of interest from a past date on the amount of the main sum awarded (or on a part of it) this supplemental payment, the size of which grows from day to day by taking a fraction of so much per cent. per annum of the amount on which interest is ordered, and by the payment of which further growth is stopped, should not be treated as interest attracting income tax. It is not capital. It is rather the accumulated fruit of a tree which the tree produces regularly until payment.'

[24] Lord Wright (beginning [1947] 1 All ER 469 at 472, [1947] AC 390 at 399) said:

> 'The contention of the appellant may be summarily stated to be that the award under the Act cannot be held to be interest in the true sense of that word because it is not interest but damages, that is, damages for the detention of a sum of money due to the respondent from the appellant and hence the deduction made as being required under the All Schedules Rules of the Income Tax Act, 1918, r 21, is not justified because the money was not interest. In other words, the contention is that money awarded as damages for the detention of money is not interest and has

not the quality of interest. Evershed J, in his admirable judgment, rejected that distinction. The appellant's contention is, in any case, artificial and is, in my opinion, erroneous because the essence of interest is that it is a payment which becomes due because the creditor has not had his money at the due date. It may be regarded either as representing the profit he might have made if he had had the use of the money, or, conversely, the loss he suffered because he had not that use. The general idea is that he is entitled to compensation for the deprivation. From that point of view it would seem immaterial whether the money was due to him under a contract, express or implied, or a statute, or whether the money was due for any other reason in law. In either case the money was due to him and was not paid, or, in other words, was withheld from him by the debtor after the time when payment should have been made, in breach of his legal rights, and interest was a compensation whether the compensation was liquidated under an agreement or statute, as, for instance, under the Bills of Exchange Act, 1882, s 57, or was unliquidated and claimable under the Act as in the present case. The essential quality of the claim for compensation is the same and the compensation is properly described as interest.'

[25] Finally, there is Lord Simonds (beginning [1947] 1 All ER 469 at 476, [1947] AC 390 at 406):

'I come then to the second stage and ask: What is the character of interest allowed under the Act of 1833, s 28? Here the argument is that, call it interest or what you will, it is damages and, if it is damages, then it is not "interest in the proper sense" or "interest proper," expressions heard many times by your Lordships. This argument appears to me fallacious. It assumes an incompatibility between the ideas of interest and damages for which I see no justification. It confuses the character of the sum paid with the authority under which it is paid. Its essential character may be the same, whether it is paid under the compulsion of a contract, a statute, or a judgment of the court. In the first case it may be called "interest", and in the second and third cases "damages in the nature of interest," or even "damages," but the real question is still what is its intrinsic character, and in the consideration of this question a description due to the authority under which it is paid may well mislead. …

Perhaps the position may become even clearer if for "damages" the word "compensation" is substituted. It would be difficult, I suppose, in a case where a man, being deprived of the use of his money, was awarded interest by way of compensation, to say that what he was awarded was not interest but something else. That is the very language of equity: cf *Vyse v Foster*. In that case, as James LJ, points out (L R 8 Ch App 328) the executors or trustees had committed a breach of trust by allowing trust money to remain outstanding on the personal

security of persons engaged in trade. They were bound, therefore, to make good the trust funds and interest. The language that James LJ, employs is illuminating. He says (p 333):

> "This court is not a court of penal jurisdiction. It compels restitution of property unconscientiously withheld; it gives full compensation for any loss or damage through failure of some equitable duty; but it has no power of punishing anyone."

The trustee must pay interest to his cestui que trust (I say nothing of his alternative remedy) to compensate for the interest he has lost. It might equally well be called damages or interest by way of damages. It is inherently a sum of money of precisely the same character as the interest awarded in a court of law under the Civil Procedure Act, 1833.

My Lords, having discussed in a general way the nature of a sum of money awarded as interest under the Civil Procedure Act, 1833, s 28, I turn to the cases decided under the Income Tax Acts to see whether they assist the appellant. I find in them just what I expected to find. The question in each case is whether the receipt is of an income or a capital nature. That is the test for income tax purposes, not whether it is called "interest" or "damages." …

It was further urged on behalf of the appellant that the interest ordered to be paid to him was not "interest of money" for the purpose of tax because it had no existence until it was awarded and did not have the quality of being recurrent or being capable of recurrence. This argument was founded on certain observations of Lord Maugham in *Moss Empires Ltd v Inland Revenue Commissioners* ([1937] AC 795) in regard to the meaning of the word "annual." It would be sufficient to say that we are here dealing with words in the Income Tax Act which do not include either "annual" or "yearly," but in any case I do not understand why a sum which is calculated on the footing that it accrues de die in diem has not the essential quality of recurrence in sufficient measure to bring it within the scope of income tax. It is surely irrelevant that the calculation begins on one day and ends on another. It is more important to bear in mind that it is income. [[1947] 1 All ER 469 at 478, [1947] AC 390 at 410–411]"

106. I consider the principle in *Riches* extends to a payment made in compromise or settlement of litigation just as it does a payment pursuant to a decision of a court – see the discussion of *London & Thames Haven* at [78] above.

107. For the above reasons I conclude that the "interest-like payment" of £6,186.32 is taxable as interest under s 369 ITTOIA.

Conclusions

108. As stated at [101] above, the amount of £48,859.10 of the Payment is taxable as employment income, pursuant to ss 6, 7 & 62 ITEPA.

109. As stated at [107] above, the amount of £6,186.32 of the Payment is taxable as interest income, pursuant to s 369 ITTOIA.

110. I understand the practical effect of the above is that the income tax deducted under PAYE has satisfied Mr Pettigrew's liability on the Payment. However, if there are any computational issues which the parties cannot agree between themselves then I GRANT LEAVE to apply to the Tribunal for determination of final figures.

Decision

111. The appeal is DISMISSED.

112. 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.

PETER KEMPSTER
TRIBUNAL JUDGE

RELEASE DATE: 26 APRIL 2018