[2019] UKFTT 409 (TC)

INCOME TAX – whether retention payment earned in or in respect of multiple tax years – no – whether earned at end of retention period – yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

TC07224

Appeal number: TC/2018/05315

BETWEEN

BENJAMIN MURPHY **Appellant**

-and-

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

TRIBUNAL: JUDGE JEANETTE ZAMAN

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1R 4QU on 10 June 2019

The Appellant appeared in person

Helen Davies, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION

1. This is an appeal by Mr Murphy against a closure notice issued under s28A(1) and (2) of Taxes Management Act 1970 on 22 April 2018 amending his self-assessment tax return for the year 2015-2016.

2. The appeal concerned whether, for the purpose of taxing earnings from employment, a payment of £30,000 received by Mr Murphy on 28 April 2015 should be apportioned across the period from 31 December 2013 to 28 April 2015 (as argued by Mr Murphy) or whether it should be taxed in its entirety in the tax year in which it was received, ie the tax year 2015-2016 (as argued by HMRC). The amendments made by HMRC to Mr Murphy's self-assessment tax return resulted in extra tax being due of £1,807.70.

3. Mr Murphy gave Notice of appeal to the Tribunal on 31 July 2018.

RELEVANT FACTS

4. HMRC prepared a bundle of papers for the hearing and Mr Murphy gave evidence. I have made the following findings of fact; further findings of fact are contained in the Discussion.

5. Mr Murphy was working outside of the UK from February 2011. For UK tax purposes, he was taxed as a non-resident in the tax year 2013-2014, returned during the tax year 2014-2015 and was resident in the UK for the tax year in issue, 2015-2016.

6. Mr Murphy was employed by Booz & Company LLP ("Booz") at the time it was announced that PwC intended to acquire Booz. The Booz communications vary in their use of terminology, and I have adopted the language used in each relevant communication. The acquisition is referred to alternatively as a merger or combination, and the completion of that acquisition is sometimes referred to as the closing thereof.

7. On 30 October 2013 a memo was sent by Joe Saddi and Cesare Mainardi to all Booz staff, sharing the news that they had signed a conditional merger agreement for Booz to join forces with PwC to build a new and differentiated advisory business. That memo states that all staff benefits and compensation will be preserved for at least the first year and, over and above this commitment, a $50 million retention pool was to be set aside and paid out over time to encourage Booz' top talent to stay with them.

8. On 17 December 2013 a memo was sent by Cesare Mainardi and Traci Entel to Global Staff of Booz to inform them of the staff retention programme (the "SRP"), stating "The Partners of Booz and PwC recognise that our success depends on retaining what has been a key to our success – our talented people. Together, we have decided to allocate a generous $50 million retention pool in recognition of the importance Booz staff members play in our future." That memo sets out the following:

> (1) To be eligible to participate in the SRP, an individual must be an "active permanent employee of Booz in good standing" on 31 December 2013 and not have announced their resignation prior to that date.
>
> (2) Awards granted will be paid out on the first payroll date following the first anniversary of the completion of the combination between Booz and PwC (the "Payment Date"), subject to the following:
>
> > (a) The completion of the combination of Booz and PwC – if the transaction does not close, all awards made under the SRP will be void and no payments will be made; and

(b) The participant's continued active employment by Booz and the members of the PwC network in good standing through to the Payment Date of the award, provided that if a participant is terminated by their employer due to redundancy prior to the Payment Date, their award will be paid out within 30 days of the date of such termination. Awards held by participants who are not in good standing on, or have announced their resignation prior to, the Payment Date will not vest and will not be paid out.

9. A letter from John Potter of Booz to Mr Murphy dated 20 March 2014 sets out Mr Murphy's potential entitlement under the SRP as 30% of his annual base salary as of 31 December 2013, prorated for any part-time arrangements. This results in a potential retention payment of £30,000 (the "Retention Payment"), subject to local tax and social security deductions. That letter reiterates that any awards will be "granted and paid out" on the Payment Date and "subject in all respects to the following terms and conditions and those found on the following page of this letter (in each case, as qualified by the FAQs)":

(1) The completion of the combination of Booz and PwC. If the transaction does not close, no payments will be made under the SRP; and

(2) Mr Murphy's active employment by Booz/PwC in good standing through to the Payment Date.

10. The terms and conditions attached to that letter of 20 March 2014 state that all amounts paid under the SRP shall be "treated as compensation for services for tax purposes".

11. On 4 March 2015 a further email was sent by Traci Entel to Global All Staff to summarise the SRP. That email reiterated that in order to receive a Retention Payment an individual must have been an active staff member on 31 December 2013 and remained active through to the Payment Date, this being the "Retention Period". Staff who spent time during the Retention Period on a leave of absence ("LOA") would have the amount of their Retention Payment handled on a case-by-case basis depending on the nature and purpose of the LOA. The guidelines applicable included:

(1) LOAs for family reasons (maternity/paternity/carer) will not impact Retention Payment amounts;

(2) LOAs for personal reasons (excluding family reasons related to maternity/paternity/carer) will result in the Retention Payment being prorated for the time spent on LOA during the 15-month Retention Period; and

(3) If staff are on LOA at the Payment Date, they will receive their Retention Payment upon return to active status.

12. The acquisition of Booz was completed on 3 April 2014. The Payment Date for the SRP was therefore to be the first payroll date following 3 April 2015.

13. On 23 June 2014 Traci Entel sent an email to Global All Staff which was the first of a planned series of "fact finding" emails. That dealt with the SRP (and other bonus payments) and states that staff eligible for a Retention Payment will receive their bonus in April 2015, specifically the pay period following the one-year anniversary of the closing date of the transaction.

14. Mr Murphy received a Retention Payment under the SRP of £30,000 on 28 April 2015.

RELEVANT LEGISLATION

15. Section 62 in Part 3 of Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003") sets out the meaning of earnings:

"**62 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.

(3) For the purposes of subsection (2) "money's worth" means something that is—

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

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

(4) Subsection (1) does not affect the operation of statutory provisions that provide for amounts to be treated as earnings (and see section 721(7))."

16. Chapter 4 of Part 2 of ITEPA 2003 then deals with the taxable earnings of UK resident employees:

"Taxable earnings

14 Taxable earnings under this Chapter: introduction

(1) This Chapter sets out for the purposes of this Part what are taxable earnings from an employment in a tax year in cases where section 15 (earnings for year when employee UK resident) applies to general earnings for a tax year.

(2) In this Chapter—

(a) sections 16 and 17 deal with the year for which general earnings are earned, and

(b) sections 18 and 19 deal with the time when general earnings are received.

(3) In the employment income Parts any reference to the charging provisions of this Chapter is a reference to section 15.

UK resident employees

15 Earnings for year when employee UK resident

(1) This section applies to general earnings for a tax year for which the employee is UK resident except that, in the case of a split year, it does not apply to any part of those earnings that is excluded.

(1A) General earnings are "excluded" if they—

(a) are attributable to the overseas part of the split year, and

(b) are neither—

(i) general earnings in respect of duties performed in the United Kingdom, nor

(ii) general earnings from overseas Crown employment subject to United Kingdom tax.

(2) The full amount of any general earnings within subsection (1) which are received in a tax year is an amount of "taxable earnings" from the employment in that year.

(3) Subsection (2) applies whether or not the employment is held when the earnings are received.

(4) Any attribution required for the purposes of subsection (1A)(a) is to be done on a just and reasonable basis.

(5) The following provisions of Chapter 5 of this Part apply for the purposes of subsection (1A)(b) as for the purposes of section 27(2)—

(a) section 28 (which defines "general earnings from overseas Crown employment subject to United Kingdom tax"), . . .

(b) sections 38 to 41 (which contain rules for determining the place of performance of duties of employment), and

(c) section 41ZA (which is about determining the extent to which general earnings are in respect of United Kingdom duties)].

(6) Subject to any provision made in an order under section 28(5) for the purposes of subsection (1A)(b), provisions made in an order under that section for the purposes of section 27(2) apply for the purposes of subsection (1A)(b) too.

Year for which general earnings are earned

16 Meaning of earnings "for" a tax year

(1) This section applies for determining whether general earnings are general earnings "for" a particular tax year for the purposes of this Chapter.

(2) General earnings that are earned in, or otherwise in respect of, a particular period are to be regarded as general earnings for that period.

(3) If that period consists of the whole or part of a single tax year, the earnings are to be regarded as general earnings "for" that tax year.

(4) If that period consists of the whole or parts of two or more tax years, the part of the earnings that is to be regarded as general earnings "for" each of those tax years is to be determined on a just and reasonable apportionment.

(5) This section does not apply to any amount which is required by a provision of Part 3 to be treated as earnings for a particular tax year.

17 Treatment of earnings for year in which employment not held

(1) This section applies for the purposes of this Chapter in a case where general earnings from an employment would otherwise fall to be regarded as general earnings for a tax year in which the employee does not hold the employment.

(2) If that year falls before the first tax year in which the employment is held, the earnings are to be treated as general earnings for that first tax year.

(3) If that year falls after the last tax year in which the employment was held, the earnings are to be treated as general earnings for that last tax year.

(4) This section does not apply in connection with determining the year for which amounts are to be treated as earnings under Chapters 2 to [10] of Part 3 (the benefits code).

When general earnings are received

18 Receipt of money earnings

(1) General earnings consisting of money are to be treated for the purposes of this Chapter as received at the earliest of the following times—

Rule 1

The time when payment is made of or on account of the earnings.

Rule 2

The time when a person becomes entitled to payment of or on account of the earnings.

Rule 3

If the employee is a director of a company and the earnings are from employment with the company (whether or not as director), whichever is the earliest of—

(a) the time when sums on account of the earnings are credited in the company's accounts or records (whether or not there is any restriction on the right to draw the sums);

(b) if the amount of the earnings for a period is determined by the end of the period, the time when the period ends;

(c) if the amount of the earnings for a period is not determined until after the period has ended, the time when the amount is determined.

(2) Rule 3 applies if the employee is a director of the company at any time in the tax year in which the time mentioned falls.

(3) In this section "director" means—

(a) in relation to a company whose affairs are managed by a board of directors or similar body, a member of that body,

(b) in relation to a company whose affairs are managed by a single director or similar person, that director or person, and

(c) in relation to a company whose affairs are managed by the members themselves, a member of the company,

and includes any person in accordance with whose directions or instructions the directors of the company (as defined above) are accustomed to act.

(4) For the purposes of subsection (3) a person is not to be regarded as a person in accordance with whose directions or instructions the directors of the company are accustomed to act merely because the directors act on advice given by that person in a professional capacity.

(5) Where this section applies—

(a) to a payment on account of general earnings, or

(b) to sums on account of general earnings,

it so applies for the purpose of determining the time when an amount of general earnings corresponding to the amount of that payment or those sums is to be treated as received for the purposes of this Chapter."

SUBMISSIONS

17. Mr Murphy argued that the Retention Payment was for continued active employment in good standing for the Retention Period as part of a retention strategy employed by PwC and Booz.

18. The Retention Payment was earned in, and thus "for", this 15-month period and should be apportioned across the three tax years covered by this period on a just and reasonable basis in accordance with s16 ITEPA 2003, being 4/17ths in 2013-2014, 12/17th in 2014-2015 and 1/17 in 2015-2016.

19. Mr Murphy referred to HMRC's Employment Income Manual (in particular to paragraphs EIM40008, EIM42201, EIM42202 and EIM42207) and argued that these paragraphs supported his interpretation of s16. He also referred to the approach taken by Lord Oliver in *Bray v Best* [1989] STC 159.

20. HMRC's contention was that the full amount of the Retention Payment is liable to tax as earnings from Mr Murphy's employment in the tax year 2015-2016:

(1) There is no requirement in s62 ITEPA 2003 that an amount is earned over a period.

(2) Section 15(1) applies to general earnings for a tax year for which an employee is UK resident except that, in the case of a split year, it does not apply to any part of the earnings that are excluded. The tax year 2015-2016 was not a split year so no amount is excluded.

(3) Section 15(2) states that the full amount of any general earnings within s15(1) which are "received" in a tax year is an amount of taxable earnings from the employment in that year.

(4) Section 18 sets out the rules for determining when earnings are received for this purpose, and in the present instance that is the earlier of the date when it is paid and the date when the person becomes entitled to it.

(5) Mr Murphy was paid the Retention Payment on 28 April 2015. This is also the date he became entitled to it – he only became so entitled once he had met the conditions which included that he was still actively employed by Booz or PwC at the Payment Date.

(6) Section 16 ITEPA 2003 does not apply. The question of the year that earnings are "for" is only relevant where earnings are chargeable on an earnings basis, and this only applies to certain individuals who are not UK resident or domiciled when amounts are earned.

(7) Even if s16 ITEPA 2003 did apply, the Retention Payment was not earned over the period from December 2013 to April 2015. It was a one-off payment, and if at any time in that period Mr Murphy had ceased to meet the eligibility criteria he would not have been entitled thereto.

DISCUSSION

21. The parties were agreed that the Retention Payment constitutes earnings in relation to Mr Murphy's employment with Booz within s62 ITEPA 2003.

22. The charging provision is s15 ITEPA 2003, and s15(1) applies to "general earnings for a tax year for which the employee is UK resident". It was agreed that Mr Murphy was UK resident for the tax year 2015-2016, so the provisions applicable to split years are not relevant.

23. Section 15(2) states that the full amount of any general earnings within s15(1) which are received in a tax year is an amount of taxable earnings from the employment in that tax year. HMRC state that this provision requires that you then consider the provisions relating to timing

of receipt in s18 ITEPA 2003, and that s16 ITEPA 2003 (which Mr Murphy relies upon) is not relevant. In support of this contention, HMRC refer to the Explanatory Notes to s16 which explain that in applying the residence tests under Chapters 4 and 5 of Part 2 of ITEPA 2003 it is necessary to know whether general earnings are general earnings for a particular tax year. HMRC argue that it follows from this that s16 ITEPA 2003 is not relevant in circumstances where the employee is UK resident throughout a tax year. They also refer to paragraph 40008 of HMRC's Employment Income Manual, which states that the question of when earnings are for "has no relevance when deciding the tax year in which the tax charge arises".

24. I do not agree with HMRC's approach and conclude that I must consider the application of s16 to the Retention Payment. Section 15(2) refers to the "full amount of any general earnings within sub-section (1)", which requires consideration of the earnings within that sub-section and s15(1) uses the phrase "general earnings for a tax year". Section 16(1) then "applies for determining whether general earnings are general earnings "for" a particular tax year" for the purposes of Chapter 4. There is nothing in s16 which states that it does not apply where an employee is UK resident – the Explanatory Notes may set out when it is expected that the definitions in s16 will be particularly useful, but they cannot (without more) do more than that.

25. Furthermore, HMRC's approach takes no account of the amendments which have been made to s15 ITEPA 2003. At the time of enactment, it read:

> "**15 Earnings for year when employee resident, ordinarily resident and domiciled in UK**
>
> (1) This section applies to general earnings for a tax year in which the employee is resident, ordinarily resident and domiciled in the United Kingdom.
>
> (2) The full amount of any general earnings within subsection (1) which are received in a tax year is an amount of "taxable earnings" from the employment in that year.
>
> (3) Subsection (2) applies—
>
> (a) whether the earnings are for that year or for some other tax year, and
>
> (b) whether or not the employment is held at the time when the earnings are received."

26. That version of s15(3) was therefore completely clear that, where the employee is UK resident, the full amount of any general earnings received in a tax year is the amount of taxable earnings from the employment in that year, irrespective of whether the earnings are for that year or for some other tax year. This would give the result for which HMRC argue here – ie that s16 ITEPA 2003 does not apply, and you proceed straight to s18 ITEPA 2003 and the explanation of when earnings are treated as received.

27. However, that version of s15(3) at paragraph [25] above was replaced by that set out at paragraph [16] above by paragraph 9(3) of Schedule 7 to the Finance Act 2008 with effect for the tax year 2008-2009 and subsequent tax years. That substitution retains what was originally s15(3)(b) but deletes s15(3)(a). There is now nothing in s15 itself (or elsewhere) that removes the need to consider when earnings are "for". Accordingly, I have considered whether the Retention Payment is "for" the Retention Period or for the tax year 2015-2016.

28. Mr Murphy argued that in considering whether the Retention Payment was for the Retention Period, I should have regard to the decision in *Bray*, where Lord Oliver had stated that at [166G] the period to which any given payment is to be attributed depended on all the circumstances, including its source and the intention of the payer. I do not find that decision to be helpful or relevant here, as s16 contains its own explanation of the meaning of "for" a

particular tax year. Section 16(2) provides that general earnings that are "earned in, or otherwise in respect of, a particular period" are to be regarded as general earnings for that period. Section 16(4) then provides for a just and reasonable apportionment to be made where the period consists of the whole or parts of two or more tax years.

29. I have considered whether the Retention Payment was earned in or otherwise in respect of the Retention Period.

30. The following conditions needed to be satisfied for Mr Murphy to become entitled to receive the Retention Payment:

(1) he had to be employed "in good standing" on 31 December 2013,

(2) the acquisition of Booz by PwC needed to complete,

(3) Mr Murphy needed to be employed "in good standing" on the Payment Date, and

(4) he must not have announced his resignation before the Payment Date.

31. The Retention Payment was a one-off fixed percentage (30%) of Mr Murphy's salary as at 31 December 2013.

32. Mr Murphy drew my attention to the provisions dealing with employees who had had a LOA, or who were made redundant before the Payment Date, in support of his contention that the right to a Retention Payment was earned in the Retention Period.

33. In the memo of 17 December 2013 it is stated that payment of the Retention Payment is subject "in all respects" to the two conditions then specified, namely completion of the acquisition and continued active employment until the Payment Date. The qualification to the latter is that if an employee's employment is terminated due to redundancy prior to the Payment Date, their award will be paid out within 30 days of the termination.

34. This is effectively a "no fault" exception to the continued employment requirement, and the right to this payment only crystallises if an employee is made redundant. The qualification does suggest a possible oddity, in that at the date of the memo it was in theory possible that an employee could be made redundant at a time when it was not yet known whether the completion of the acquisition would occur, and it is not clear from the description of the applicable conditions whether the requirement for completion to occur overrides the right of an employee made redundant to receive the Retention Payment within 30 days of the termination of their employment – it is clear that it was envisaged that the individual was to be absolved of the need to remain employed at the Payment Date, and would not have to wait until the Payment Date for payment to be made. It is not, however, clear whether an individual who was made redundant could receive payment even if the acquisition had not yet completed (in circumstances where the acquisition remained in progress rather than having been aborted). However, it is not necessary for me to make a finding as to what would have happened in this scenario. Suffice to say that redundancy would have operated to accelerate payment of the Retention Payment and removed the need to be employed at the Payment Date.

35. The guidelines that were to be applied to employees who took a LOA during the Retention Period were set out in the email of 4 March 2015. These guidelines involve the possibility of a Retention Payment being reduced (on a pro rata basis) if certain types of LOA had been taken during the Retention Period, or payments being made after the Payment Date if employees were on a LOA at the Payment Date.

36. The conditions applicable to the SRP do reflect a need for continued employment during the Retention Period. However, I do not consider that it therefore follows that the Retention Payment was earned in or in respect of that period. I have concluded, notwithstanding the

features outlined in paragraphs [32] to [35] above, that the entitlement to the Retention Payment did not accrue during the Retention Period - the fact that an employee was still employed in good standing on, say, 1 January 2015 would have meant nothing if they had then resigned on 2 January 2015. This is clear from the memo to Global Staff of 17 December 2013 and the letter to Mr Murphy of 20 March 2014. The letter of 20 March 2014 describes the award as being granted and paid out on the Payment Date, and I consider that this accurately captures the position – it is only on the Payment Date that employees become entitled to a payment (subject to the specific qualification regarding redundancy).

37. This absence of any accruing right to some or all of the Retention Payment leads me to conclude that the Retention Payment was not earned in the Retention Period. The reference in s16(2) to an amount being otherwise in respect of a particular period is meant to encompass a wider range of situations, but again I do not consider that the Retention Payment was in respect of the 15-month Retention Period. It was a reward for continuing in active employment until the Payment Date, and was in respect of being employed at that date.

38. I have therefore concluded that the Retention Payment was earned on, or otherwise in respect of, Mr Murphy's employment by Booz/PwC at the Payment Date. The Retention Payment is therefore part of Mr Murphy's general earnings for 2015-2016, and is taxable in that year if it is are received in that year (in accordance with s15(2)).

39. Section 18(1) provides that, for employees who are not directors, general earnings consisting of money are to be treated for the purposes of Chapter 4 as received at the earliest of (1) the time when payment is made of or on account of the earnings, and (2) the time when a person becomes entitled to payment of or on account of the earnings.

40. The Retention Payment was made to Mr Murphy on 28 April 2015. On the basis of my findings of fact and the factors mentioned at paragraphs [30] and [31] above, and as explained in paragraph [36], I have concluded that Mr Murphy only became entitled to receive the Retention Payment on 28 April 2015. It follows from this conclusion that, irrespective of whether I adopt the reasoning advanced by HMRC (as to the irrelevance of s16 and the need to consider only s18) or Mr Murphy (as to the need to address the question of when the Retention Payment is for in accordance with s16), I have concluded that the whole of the Retention Payment is taxable in the tax year 2015-2016.

CONCLUSION

41. The full amount of the Retention Payment is taxable in the tax year 2015-2016. Mr Murphy's appeal is dismissed and the additional tax of £1,807.70 is due.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

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

JEANETTE ZAMAN
TRIBUNAL JUDGE

RELEASE DATE: 24 JUNE 2019