NCN: [2021] UKFTT 232 (TC)

TC08181

INCOME TAX-employee contractually entitled to ICT allowance-allowance created equal pay issues for employer-lump sum payment made to employee for giving up right to ICT allowance-whether an emolument of the employment within section 62 Income Tax (Employment and Pensions) Act 2003

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2019/03892

BETWEEN

PATRICK MCALLISTER **Appellant**

-and-

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

TRIBUNAL: JUDGE MARILY MCKEEVER

The hearing took place on 9 June 2021. The form of the hearing was V (video) held on the VHS platform. All parties attended by video including several observers from HMRC and a Trade Union official who had been involved in the negotiations referred to in the decision. A face to face hearing was not held because of the social distancing restrictions as a result of the Covid-19 pandemic and it was considered appropriate to hold the hearing by video. The documents to which I was referred are: a Hearing Bundle comprising 446 pages, an Authorities Bundle of 192 pages and the Skeleton Arguments of the Appellant and the Respondents.

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

Mr John McVeigh, accountant, for the Appellant

Mr Joshua Carey, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. Mr McAllister was employed by the Commission of the Northern Ireland Assembly (NIA) as an application development analyst. He led a team of software developers and his role was to provide technical assistance to the NIA and its staff in relation to the software used to carry out the Assembly's legislative business. This case concerns the nature of a lump sum payment of £44,860 made to Mr McAllister for giving up his contractual right to an ICT allowance which was part of his remuneration.

2. HMRC contend that it was an emolument of his employment within section 62 Income Tax (Employment and Pensions) Act 2003 (ITEPA) and so taxable as earnings.

3. Mr McAllister argues that the payment did not flow from his employment and is not an emolument of it. He submits that it falls within section 401 ITEPA which applies to certain payments received in connection with, among other things, a change in the earnings from a person's employment and that, by virtue of section 403 ITEPA, the first £30,000 of that payment is tax free.

4. I had before me the bundles of documents and authorities referred to above and I heard oral witness evidence from Mr McAllister.

THE LAW

5. Section 6 of ITEPA provides that the charge to tax on employment income is a charge to tax on general earnings. Section 7 of ITEPA provides that "general earnings" are earnings within chapter 1 of Part 3 ITEPA. Section 62 ITEPA, which is within chapter 1 of Part 3 provides:

> **"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."

6. The short question in the present case is whether the payment made to Mr McAllister was an "emolument of the employment".

BACKGROUND AND FACTS

7. I set out below the background to this case and my findings of fact.

8. Mr McAllister had an important role within the Commission. His starting salary was £22,311 p.a.. This was set out in his contract of employment, under the heading "Pay". The contract continued "In addition to your starting salary the post also attracts an ICT allowance of £5,640 per annum…".

9. The ICT allowance had been paid for a number of years and had been in existence before 2010. The rationale for the ICT allowance was set out in a letter dated 2 March 2015 from the Commission to Mr McAllister's Trade Union, the Northern Ireland Public Service Alliance (NIPSA). It stated:

> "…the purpose of the ICT allowance is to recognise the skills and competencies that are required of and exercised by staff in the ICT discipline and to reflect the need to have ICT skills available in order to meet service requirements outside normal office hours if required… . The ICT allowance is payable exclusively to staff who occupy posts that are within the ICT discipline and require the post holder to exercise particular ICT skills and competencies."

10. In 2010, a pay and grading review was carried out and this was ratified by the NIA Commission in early 2011. The grades and pay determined by the review took into account the particular skills which people on that grade were expected to have. The report stated that "…there is not a strong enough business case to deviate away from standard pay bands for each grade" and recommended that payment of allowances should be discontinued and phased out over a period of time. In other words, the new grading regime allocated Mr McAllister and his colleagues a grade which took account of their specialist ICT skills and set their pay bands accordingly. There was therefore no justification for paying an additional allowance for having ICT skills.

11. Equal pay reviews were carried out in 2011 and 2013 (after the regrading exercise). These showed that at the relevant grades, men were statistically more likely to receive the ICT allowance than women. The Commission believed that there was a risk of challenge by female staff in the relevant grades. The letter of 2 March 2015 went on to say:

> "We believe there is an unfairness and possible risk of challenge arising from the fact that 18 members of staff are paid allowances even though, since November 2010, the posts they currently occupy have been graded as equivalent to other posts at the same grade who [sic] are not in receipt of allowances."

12. In short, the 2011 regrading had removed the justification for the additional ICT allowance. Those continuing to receive the allowance were predominantly men. Women, on the same grade in other disciplines were not receiving an allowance and the Commission was concerned about the possibility of equal pay claims being made against it.

13. The union had a conflict of interest. On the one hand, it was representing the disadvantaged employees who might have an equal pay claim. On the other, they also represented the employees receiving the allowances which gave rise to the potential discrimination.

14. The Commission and NIPSA were engaged in negotiations as to how the allowances might be dealt with and the letter mentioned the possibility of buying out the allowances.

15. Mr McAllister was aware that his employer and NIPSA were having discussions about the ICT allowance, but the employees were unaware of the nature of the discussions. Neither he, nor any of the other employees had any direct contact with the employers. All negotiations with the NIA were conducted by NIPSA on behalf of its members and all communications about the Commission's proposals were conveyed by NIPSA to its members.

16. On the afternoon of 31 March 2015, Mr McAllister and his ICT colleagues were called to a meeting with NIPSA. At that meeting, NIPSA told them that the NIA wanted to remove the ICT allowance from their contract of employment because of an equal pay litigation risk. NIPSA agreed that the risk was high and a challenge would be difficult to defend. The union was aware of an imminent equal pay claim and had a duty to inform disadvantaged members of the possibility of claiming and support members to make such claims.

17. Mr McAllister's evidence was that NIPSA stated that if an equal pay claim was successful, the Commission would unilaterally remove the allowance from the contract of

employment rather than pay the allowance to all staff. This was repeated in a letter of 23 September 2019 from a Mr Toner, who was a NIPSA official involved in the negotiations, to Mr McAllister. If this had happened, Mr McAllister's remedy would have been to claim constructive dismissal and make a claim against his employer for breach of contract. As we will see, there is nothing in the documentary evidence to suggest that the NIA would unilaterally have withdrawn the allowance. However, I cannot know what was said during the oral negotiations between the two sides and I make no finding as to whether there was an actual risk of unilateral change.

18. NIPSA went on to say that, on this basis, they had negotiated a compensation payment with the NIA in return for the employees' agreement to change their terms and conditions of employment to remove the ICT allowance. There were no details of the payment, but the figure of £30,000 was mentioned and Mr McAllister said he was told it would be tax free. In addition to the lump sum payment, the ICT allowance would continue to be paid up to 31 March 2016 and the change in the terms and conditions of employment would take effect from 1 April 2016.

19. NIPSA made it clear that there were "no strings attached" and no clawback provisions. The employees were not required to commit to continue in their employment for any period. They were free to hand in their notice at any time and if they did leave, before or after 1 April 2016, there would be no requirement to repay any of the ICT allowance payments or any part of the lump sum.

20. The offer had to be accepted by a sufficient number of employees (so as to mitigate the equal pay risk) and the employees had to agree to accept the offer by the end of that day; 31 March 2015. The reason for the urgency was that the agreement had to be reached in the current financial year as the NIA had a sufficient budget surplus to pay the compensation in the current year. Owing to cuts and other financial constraints, it would not have the funds in the following financial year to make the payments.

21. NIPSA advised staff to accept the offer because, if they did not, it would be withdrawn anyway, they would then have to engage in litigation to obtain a remedy and the offer was more than the maximum compensation for constructive dismissal.

22. There was clearly a great deal of pressure on Mr McAllister and the other employees to agree to the proposal, without having any independent advice or even being able to discuss it with their families.

23. Mr McAllister felt he had no option but to accept the offer.

24. Whilst I have some sympathy for the position Mr McAllister found himself in, neither the pressure he was put under, nor the possibility that the Commission might have taken other action if agreement was not reached can affect the nature of the payment which was actually made.

25. The offer was formalised in a memorandum dated 17 September 2015 from the head of the NIA's Human Resources which confirmed the changes to the terms and conditions of employment "as a result of the decision you have taken regarding your ICT allowance". The payment was described as "a compensation payment to buy-out your ICT allowance". It confirmed that the allowance would be paid for the 2015/16 financial year and the change would be effective from 1 April 2016. The memorandum was accompanied by an acceptance form which Mr McAllister signed on 25 September 2015.

26. This was followed by a letter from the Director of Corporate Services of the NIA on 30 September 2015, confirming the nature of the agreement in respect of the removal of the contractual right to receive the ICT allowance:

(1) The negotiations had involved three groups of staff receiving additional allowances (including the ICT staff) and resulted from the equal pay claim risk.

(2) The ICT staff would give up their contractual right to the ICT allowance in exchange for a compensatory payment, in Mr McAllister's case of £44,860, and the continuation of the ICT allowance for the financial year 2015/16. The allowance in that year was £5,640.

(3) The only condition was the removal of the allowance from the employee's contract of employment.

(4) There was no commitment to remain employed by the Commission for any period of time beyond the date of the payment and there was no requirement to refund any of the payment (whether the one-off or the 2015/16 allowance) if they in fact left.

27. Mr McAllister received the lump sum payment with his pay for October 2015 and tax and National Insurance Contributions were deducted under PAYE.

28. In April 2016 Mr McAllister began his dialogue with HMRC, arguing that the payment should not have been taxed. To support his case, he made Freedom of Information requests for certain documents regarding the negotiations between the NIA and NIPSA. These documents, which had been redacted were included in the Hearing Bundle.

29. The first was a discussion paper prepared by the Director of Corporate Services of the Commission regarding the payment of allowances, to be discussed on 18 February 2015. The paper noted earlier discussions on the subject and that despite the Commission agreeing, in 2011, with the recommendation in the 2010 Pay and Grading Report that the allowance should be removed, efforts to negotiate the removal of the allowances with the trade unions had failed and the allowances continued to be paid. The matter was now urgent because a post which would attract allowances was vacant and needed to be filled. The paper referred to four options for dealing with the allowances which had previously been considered and a new suggestion; that the allowances be bought out. The options were:

(1) Do nothing

(2) Cease paying the allowances with immediate effect

(3) Phased cessation of allowances

(4) Allowance to be retained until a post became vacant.

(5) Buy-out.

30. The paper considered the pros and cons of each option, although much of this was redacted. It was, however, clear that motivating staff, or at least, avoiding demotivating staff and causing a fall in morale, which could affect the services provided, was one of the considerations.

31. The conclusion was that option (4) was the preferred option. One reason for this was the uncertainty about whether the trade unions would agree to a buy-out, but it was suggested that they could discuss this with the unions in tandem with discussions about option (4).

32. On 2 March 2015, the NIA wrote, on a "without prejudice" basis, to NIPSA referring to previous discussions. It set out the rationale for the ICT allowances (see [9] above) and the pay and grading review and subsequent recommendation to phase out allowances. The NIA wished to continue discussions about a possible buy-out of the allowances. The letter emphasised that any agreement had to take place in that financial year and that the precise terms were open for negotiation.

33. A further letter of 16 March 2015 referred to option (4) (continue with allowances until a post fell vacant) and to the buy-out option. A note of the buy-out proposals was attached. This included a draft form of acceptance (not ultimately used) which stated "I understand that this amount may be liable for income tax". It also contained a schedule setting out how the buy-out amount might be calculated. Essentially:

(1) For each recipient of an allowance, the number of years to normal retirement age was calculated.

(2) The years to retirement were put into five year bands. For example, an employee who would retire in 10 to 15 years was in the 10 year band and those with 25 or more years to go were in the 25 year band.

(3) The amount of the allowance was multiplied by the banded years to retirement.

(4) That figure was discounted to take account of the fact that the employee might leave before reaching retirement. The further away the normal retirement date was, the higher the discount. A person who would retire within the next five years would get 60% of the sum. A person who would not retire for another 25 years would receive only 30%.

34. This approach had been set out in the February Commission memorandum, although the applicable percentages were different. As set out in the 2 March 2015 letter, the amount was a matter for negotiation. I did not have the final calculation schedule, but HMRC's statement of case indicated that the final figure also included an amount equal to the 2015-16 allowance and an additional amount calculated by reference to the difference between the relevant percentage and the year's allowance. Presumably these increases were negotiated by NIPSA.

35. In any event, Mr McAllister's payment, calculated on this basis was £44,860.

36. The bundle contained correspondence between the NIA, NIPSA and HMRC regarding the tax treatment of the payments. The NIA and NIPSA argued that they were tax free, but HMRC took the opposite view, that the payments were subject to income tax and National Insurance Contributions when they were made.

37. In April 2016, Mr McAllister began a correspondence with HMRC concerning the tax treatment of the payment. He subsequently submitted a self-assessment tax return, claiming the payment was not taxable and received a repayment of £11,996.

38. On 20 August 2018, HMRC opened an enquiry into the tax return and, specifically, the tax treatment of the lump sum payment.

39. On 10 January 2019 a formal closure notice was issued, confirming HMRC's view that the payment was taxable. Mr McAllister requested a review of the decision and the review conclusion letter of 2 May 2019 upheld the original decision.

40. Mr McAllister submitted his Notice of Appeal to the Tribunal on 31 May 2019.

THE APPELLANT'S SUBMISSIONS

41. The payment was a non-contractual payment to obtain a release from the contingent liability to pay the ICT allowance. The employer's sole objective was to avoid an equal pay risk. The payment was not an emolument of the employment for the following reasons.

42. It was an ex-gratia payment.

43. The payment was not in return for any services past, present or future.

44. It was not an inducement to enter into or continue in employment.

45. He received the payment, not for acting as an employee, but so that the employer could avoid equal pay vulnerabilities.

46. The only condition for the payment was the surrender of the ICT allowance.

47. The payment was not directly linked to the employment and was made for some other reason.

THE RESPONDENT'S SUBMISSIONS

48. The lump sum essentially represented the future payments of the ICT allowance which were a taxable part of the Appellant's salary.

49. The lump sum was paid in order to motivate the employees to remain and continue to provide the important services to the Commission and so were "from" the employment and accordingly an emolument of the employment.

DISCUSSION

50. The question whether a particular payment constitutes emoluments of an employment is one which has kept the Courts and Tribunals occupied for many years. Both parties referred to a number of cases and I consider the principles which have been established by the cases and their application to the present case.

51. Mr McVeigh, in his submissions, referred to only one case, and that was on the basis that it was contained in an article in Taxation magazine. Mr McAllister, in his Notice of Appeal referred to a number of authorities and made submissions in relation to the cases relied on by the Respondents. I will address these below.

52. *Dewhurst and another v Hunter* [1932] All ER Rep 753 was a majority decision of the House of Lords. The facts were very unusual and several of the authorities mentioned below did not regard the case as providing any general principles. Commander Dewhurst was Chairman and director of a company. He was entitled to a salary. In addition, the Articles of the company provided that in the event of a director dying, resigning or otherwise ceasing to hold office, he would be paid, by way of "compensation for loss of office" an amount equal to the remuneration received in the previous five years. Commander Dewhurst wanted to resign, but his fellow directors persuaded him to remain on the board (but not as Chairman) although he would not be expected to attend regularly. It was agreed that his salary would be significantly reduced, to £250 a year and £10,000 would be paid to him in return for his giving up his right to the payment for loss of office. There was no requirement that he continue to provide his services for any particular period of time.

53. Their Lordships did not make any finding as to whether the compensation for loss of office, if paid, would have been subject to income tax.

54. The majority characterised the £10,000 payment as a payment for a release of a contingent liability and not a payment for past or future services. Lord Atkin said:

> "The 10,000 pounds was not paid for past remuneration; for the condition of its becoming payable, ie, loss of office, never was performed. It was not paid for future remuneration, for that was expressed to be 250 pounds per annum, which was to be the sole remuneration. It seems to me that a sum of money paid to obtain a release from a contingent liability under a contract of employment cannot be said to be received "under" the contract of employment, is not remuneration for services rendered or to be rendered under the contract of employment, and is not received "from" the contract of employment."

55. Lord Thankerton made similar comments.

56. Mr McAllister submitted that the case provided authority that a payment made to secure the release of a right to payments which would themselves be taxable if received was not an

emolument "from" employment and that, as the payment to Commander Dewhurst was not in return for services, it was not "from employment".

57. As noted, the majority did not make any finding as to whether the "compensation for loss of office", if paid, would have been taxable. In any event, the rationale of the decision was that Commander Dewhurst entered into a new contract with the company and the payment was in return for a release of the company from a future contingent liability.

58. The circumstances of the present case are very different. We are not dealing with an existing contingent liability for a sum of money which would have to be paid at a later date on the occurrence of specified events, but with a variation to the terms and conditions of employment relating to a contractual payment which would be made only so long as the employee remains in employment. I do not find that *Dewhurst* assists the Appellant.

59. Mr McAllister next referred to *Shilton v Wilmhurst* [1991] 1 AC 684, a further House of Lords case which involved footballer Peter Shilton, the former England goalkeeper. In 1982, Mr Shilton was employed by Nottingham Forest Football Club. The club agreed to transfer Mr Shilton to Southampton Football Club in return for a transfer fee. Mr Shilton agreed to enter into a four year contract to play for Southampton on payment to him by Nottingham Forest of a lump sum of £75,000.

60. Lord Templeman said, at page 689:

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

61. The Court held that the payment of £75,000 was an inducement to provide future services at Southampton and so was taxable.

62. Mr McAllister submitted that the payment he received was clearly not for past services and was not an inducement to provide future services as it was unconditional. It was therefore paid for "some other reason", being the NIA's desire to mitigate a potential equal pay vulnerability and so was not taxable.

63. Although Mr McAllister's payment was unconditional, it will be apparent from the cases discussed below that a payment can be "from" the employment even if there is no obligation to provide future services.

64. Mr McAllister also referred to *Mairs v Haughey* [1994] 1 AC 303, a further House of Lords case. The taxpayer worked for Harland & Wolff and had contingent rights in a non-statutory enhanced redundancy scheme. As part of a reconstruction of the company, the employees were to be transferred to another company on new terms and conditions. Under the new terms, the employees gave up their rights to the enhanced redundancy payments and received a lump sum made up of two elements. Element A was 30% of the amount they would have been paid under the scheme had they been made redundant at the time of the transfer, Element B was calculated by reference to an employee's number of years of service. It was held that Element B was taxable, but Element A was not.

65. Mr McAllister referred to a passage from the judgement in the Court of Appeal which was quoted in the Judgement of Lord Woolf in the House of Lords:

> "…I consider it to be clear that a substantial part of that sum was paid to the taxpayer to compensate him for the loss of his contingent rights under the scheme. I regard this as clear from the wording of the documentation to which I have earlier referred. In my opinion this view is further supported by the considerations that element A of the total payment was calculated with reference to 30 per cent. of the amount of the enhanced redundancy payment which the taxpayer would have received if he had been declared redundant in the summer of 1989, and that the special commissioner found as a fact that the 30 per cent. certainly did not overvalue the employees' contingent rights under the scheme. I am further of opinion that this payment in respect of the loss of the contingent rights under the scheme cannot be regarded as an inducement to enter into new employment with H. & W. 1989; it was paid in compensation for a loss, not as an inducement to remain in employment or enter into new employment."

66. Lord Woolf, who gave the only judgement in the House of Lords agreed that the payment was not an inducement to become or remain employees. This conclusion relates to what the payment was "for". That does not determine how the payment was taxed. The principle which applies in determining whether a payment is taxable was stated by Lord Woolf as follows at page 323:

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

67. In other words, where a payment is made to compensate an employee for giving up a right to a different payment, one must look at the nature of the payment which is being replaced by the compensation. If the payment would have been taxable, so is the compensation. If the payment would not be taxable, neither is the compensation. In *Mairs v Haughey* a payment made under the enhanced redundancy scheme would not have been a taxable payment, so compensation paid for giving up the rights under the scheme was not taxable.

68. This is sometimes called the "replacement principle", that is, one must ask, what is the payment replacing, and the payment takes on the nature of the thing which is being replaced.

69. Mr McVeigh made reference to *Wilson v Clayton* [2004] All ER (D) 313 which he considered to be analogous to the present case in that employees had received a payment as compensation for giving up their contractual right to a car allowance. The High Court held that the payment was not taxable as it was a voluntary payment with no causal link to past or future services.

70. Mr Clayton had been employed by a local authority and, along with a number of other employees, had been paid a car allowance. In order to save money, the local authority terminated the employees' employments and immediately re-employed them on different terms and conditions which excluded the car allowance. Mr Clayton and others made a claim for unfair dismissal in the Employment Tribunal. The complaints were upheld and the subsequent remedy proceedings were compromised. The Employment Tribunal made an order for reinstatement of the employees on their original terms and conditions including the car allowance and also made an order for compensation based on the amount of allowance they would have received from the date of termination to the date of reinstatement. The Tribunal had no jurisdiction to order both reinstatement and compensation. The question was whether

the compensation was a payment “in connection with the termination of employment” and therefor exempt up to £30,000 under what was then section 148 of the Income and Corporation Tax Act 1988. HMRC argued that, whilst compensation for unfair dismissal would normally fall within section 148, here there was double recovery and the payment should be taxable.

71. Patton J said at [7]

> “What he and the others had lost was the additional payment by way of car allowance, and paragraphs 1(a) and (c) of the order of 12th July 2000 restored this both retrospectively and prospectively. The additional payment of a basic award under s.119 was, on any view, a bonus.”

72. He rejected HMRC’s argument that it related to past or future services. In the extraordinary circumstances of this case, the payment was a voluntary payment or “bonus” which could not be compensation for giving up the car allowance, because the employees had already been compensated under the reinstatement order and, in fact, continued to get the allowance. It was therefore held to be a payment in relation to the termination of the employee’s employment falling within section 148 and exempt from tax up to £30,000.

73. *Wilson v Clayton* turns on its own facts and does not provide any principle which is capable of applying to the present case.

74. Mr Carey also took me to a number of cases, which he discussed in chronological order.

75. The first case was *Cameron v Prendergast* [1940] AC 549. In this case, Mr Cameron was, and had for many years been, director of a company. He told his fellow directors he wished to retire. The other directors wished to retain his services and offered to pay him £45,000 if he did not resign. Mr Cameron agreed to accept the payment and to remain on the board in an advisory capacity, at a salary reduced from £1,500 a year to £400 a year. Mr Cameron was not required to continue in office for any specified period.

76. The House of Lords held that an agreement not to cease giving services necessarily involved an agreement to continue to render those services and that the consideration for the agreement was a profit from the directorship and subject to income tax.

77. Viscount Caldecote LC said this at page 554

> “I can see no difference between a promise not to resign and a promise to continue to serve as director. It is true that the appellant did not give any promise in words to continue to serve for any period of time, any more than the board by their resolution of December 31 named a term of service. It is fair to assume that, in the course of a long connection of the appellant with the company, his fellow directors had learned that they could trust him. Whether or not it was open to him, having received the sum, to resign immediately afterwards is a question which I find unnecessary to answer. The appellant's colleagues on the board no doubt knew the man with whom they had to deal, and were confident that if he received the money they were prepared to pay him they would get good value for it.”

78. The *Dewhurst* case was distinguished and said not to provide any general principle of construction. Similar comments were made in several of the cases discussed below.

79. Mr McAllister submitted that the payment in the *Cameron* case was in return for Mr Cameron agreeing to remain as director of the company when he had said he wished to resign. The main term and nature of the agreement was to continue to render services and to secure his commitment to providing future services which, he conceded, are clearly “from employment”. Mr McAllister considered that his position was different as no such conditions were required of him.

80. As noted in the passage set out at [77], there was no obligation on Mr Cameron to continue to render services for a period. He made no commitment to render future services and no such commitment was demanded of him. The other directors were relying on Mr Cameron "doing the decent thing" and at least remaining in office for a reasonable period. Viscount Maugham did suggest that that the payment was an inducement to continue to serve the company for "at least a reasonable time" although there was no obligation to do so and no quantification of what might be "reasonable".

81. The House of Lords essentially held that the payment involved an agreement to continue to provide services, even though there was no obligation to continue to provide those services for a set period and as such was a profit from the employment.

82. In *Tilley v Wales* [1943] AC 386 Mr Tilley was managing director of a company. He was entitled to a salary of £6,000 a year and to a right, on ceasing to be employed by the company to be paid a pension of £4,000 a year for ten years. The pension would be paid to his estate in the event of his death. He entered into an agreement with the company under which he released the company from the obligation to pay the pension and accepted a reduced salary of £2,000 a year and in return was paid a lump sum of £40,000, to be paid in two equal instalments. There is no suggestion in the judgements that Mr Tilley was required to work for any particular period under the new agreement.

83. The Court decided that a lump sum paid to release the company from its contingent liability to pay the pension was not taxable, but a lump sum paid in respect of a reduction in salary was a profit of the employment and taxable. The Court followed *Cameron* in deciding that if a lump sum represented future taxable income payments, it was itself taxable. Lord Simon LC said:

> "The ordinary way of remunerating the holder or the person employed is to make payments to him periodically, but I cannot think that such payments can escape the quality of income which is necessary to attract income tax because an arrangement is made to reduce for the future the annual payments while paying a lump sum down to represent the difference. My view seems to me to be supported by the decision of this House in *Cameron v. Prendergast* . In that case the respondent was a director of a company and was minded to resign his position and so obtain greater ease. His fellow directors, in the interests of the company's success, urged him not to do so, and an agreement was made between the company and himself under which his salary was reduced from 1500l. to 400l. per annum, but he also received 45,000l. This House decided that the 45,000l. was a profit from the respondent's directorship and was therefore assessable under sch. E. … I … say that, whatever part of the 40,000l. should be regarded as the equivalent of a drop in salary amounting to 4000l. a year, is within the charge on profits from the office of director."

84. Lord Thankerton took the same view.

> "My Lords, in common with all the learned judges below, I have no doubt that, in so far as the payment of the 40,000l. may be referable to the agreement to serve as managing director at a reduced salary, there is liability to tax, the decision in *Cameron v. Prendergast* being directly in point. It satisfies, in my opinion, the two tests, namely, (i.) whether it arose from the office of director within the meaning of r. 1, and (ii.) whether it is in the nature of income."

85. Mr Tilley did not have to continue to work for the company for a minimum period. There was no calculation of the amount which Mr Tilley was actually giving up. The principle was stated as being simply that if an employee agrees to continue to work at a reduced salary and

is paid a lump sum to compensate him for that reduction, the lump sum represents the salary forgone and is taxable as income arising from the office or employment.

86. Mr McAllister argued that his case is very different from Mr Tilley's because the lump sum in that case was in part paid for *agreeing to remain* as managing director on a reduced salary and Mr Tilley therefore had a commitment to provide future services. Mr McAllister contends that his situation is very different in that the payment he received was not in return for remaining in employment.

87. In my view, the cases are very similar. Mr Tilley was not under an obligation to continue in office for a period. Mr McAllister was under no obligation to continue in employment, but in agreeing to a change to his terms and conditions of employment it is implicit that he is agreeing to provide future services under those new terms for as long (or short) a period as the contract continues.

88. In *Bolam v Muller* [1947] 28 TC 471Mr Muller was managing director of a company and was entitled to a fixed salary and a commission based on the dividends paid by the company. Owing to a change in the company's financial policy, no dividend was paid between April, 1941, and August, 1942. By agreement of 30th September, 1942, in consideration of the payment of £1,250 as compensation, the Respondent surrendered his right to commission as from 1st November, 1940, during the continuance of the original service agreement which was for a two year period.

89. The payment of £1,250 was held to be remuneration as it was received in place of the bonuses which would have been taxed as profits of his employment. Atkinson J said at page 470, following *Cameron* and *Tilley*:

> "I cannot understand the view taken by the Commissioners [who found for Mr Muller]. It seems to me so plain. It is obvious, of course, that the bonuses he would have received if they had been paid under the agreement would have been profits from his employment, and the mere fact that they agree on another form of remuneration does not alter its character. They value this at £1,250. They agree upon another form of remuneration, and there is not the slightest doubt in my judgment that that was remuneration for services to be rendered, because that agreement affirms the original agreement; that means it reaffirms the obligations resting upon him to serve the company for another two years. That was the consideration for the payment of the £1,250."

90. As Mr McAllister pointed out Mr Muller was required to serve for a further two years, so it was more apparent that he was agreeing to provide further services, but the principle is essentially the same as in *Cameron* and *Tilley*.

91. The High Court case of *Holland v Geoghegan* [1972] 3 All ER 333 makes it clear that for a payment to constitute an emolument there is no need for any express or implied obligation on the employee to remain in the employment for a reasonable time.

92. In this case, Mr Geoghegan was a refuse collector for a local authority. He participated in a salvage scheme under which refuse collectors could sell items salvaged from the rubbish and the proceeds were divided between the participants in the scheme. The local authority wanted to introduce bulk containers to collect the rubbish which meant that the salvage scheme would have to come to an end. The trade union negotiations with the local authority for compensation were unsuccessful and the refuse collectors went on strike. The dispute was settled by an agreement to pay the employees £450 for the loss of their salvage rights. The payment was not made for past or current services and did not secure future services. Mr Geoghegan could leave his employment on a week's notice. The payment was nevertheless

held to be a taxable emolument of his employment. Foster J specifically addressed the question whether future services were required. He said, at pages 340 and 342:

> "The difficult point of law is whether a payment can be an emolument when the recipient is under no obligation, expressed or implied, to remain in his employment for a reasonable time, since in the majority of the cases cited to me by the Crown there was such a legal obligation. In this case, it was common ground that the taxpayer could at any time after 27 February 1969, when the strike was settled, give one week's notice terminating his employment….
>
> When, however, one looks at the number of cases in which payments are made from persons other than employers which have been held to be assessable, such as tips to waiters and taxi-cab drivers and Easter offerings to a minister of religion, the recipient could not have given any undertaking, express or implied, to remain in his employment for any period of time. In my judgment, it is not necessary for the payment to be assessable that some obligation to remain in service should be found.
>
> The question then remains: was this sum paid to the taxpayer as an emolument of his employment? The facts. In answering this question, I think it is necessary, as Lord Hodson suggested, to look at the motive or purpose of the employer in paying the sum, and the character of the sum when received by the employee. …
>
> Conclusion. In my judgment, the main purpose of the borough was to get the taxpayer back to work [although Foster J did not consider that the benefit arising to the borough was material], and the money when received by him was a form of substituted remuneration for his former rights to share in the proceeds of sale of the salvage. In my judgment, the sum of £450 was an emolument of his employment and was assessable to income tax under Sch E."

93. This makes it very clear that a payment made in substitution for a taxable part of an employee's pay is an emolument of the employment even though there is no obligation to provide future services.

94. This was reinforced in *Bird v Martland* [1982] STC 603. In that case, Mr Martland was provided with a hired company car and the company paid £350 a year towards the hire charges. The company was subsequently taken over by another company with a different policy on company cars. As a result, Mr Martland and other employees no longer had the use of company cars. To preserve good staff relations, the company gave a lump sum of £2,110 the affected employees for the loss of the use of the car. The employees were under no obligation to remain in the employment after receiving the payment and the amount of the payments was not related to the status or salary of the employees or the time for which the car had been available.

95. It was held that the payments, as compensation for the withdrawal of a taxable benefit, were emoluments of the employment.

96. Mr McVeigh sought to argue that the calculation of the payment was significant in that it was unclear what benefit the employees were giving up and the cases were connected to future earnings. As noted, there was no obligation to provide future services and the Foster J did not consider the calculation of the amount, or what it might be said to represent in terms of benefits given up, as relevant.

97. In *McGregor v Randall* [1984] STC 223, Mr Randall was a director of a company. His service contract entitled him to a salary and a commission by reference to the company's profits. The company was taken over in 1978 by another company whose policy was to pay its executives a salary only. In 1979, Mr Randall's service contract was varied by removing the

entitlement to commission, with effect from 1 June 1978. As compensation, his salary was increased and he was paid a lump sum of £6,000. The lump sum was held to be taxable as an emolument of the employment. Scott J said:

> "In my judgment, there is overwhelming authority for the proposition that where an employee is entitled, under the terms of his employment to periodic salary or commission, and accepts a lump sum in lieu of all or part of such salary or commission, then the lump sum is taxable under s 181 (see *Cameron v Prendergast (Inspector of Taxes)* [1940] AC 549, 23 TC 122; *Henley v Murray (Inspector of Taxes)* [1950] 1 All ER 908, 31 TC 351 and *Tilley v Wales (Inspector of Taxes)* [1943] AC 386 at 393, 25 TC 136 at 149). This proposition is, in my judgment, enough to conclude the case in favour of the Crown. In their letter of 24 April 1979, the employers offered to pay Mr Randall £6,000 and I quote: '... in order to obtain your agreement to the cancellation of future commission entitlement with effect from 1st June 1978.' Mr Randall accepted that sum in full and final compensation for that cancellation. The nature of the agreement between Mr Randall and his employers is set out in the letter and Mr Randall's indorsement thereon. The proposition I have referred to plainly, in my judgment, applies."

98. The judge noted that here, as in *Bolam*, the employment was intended to continue on the same terms as before subject to the agreed variation.

99. Mr McAllister sought to distinguish his case on the basis that Mr Randall's payment took effect from June 1978 and so was in respect of past services whereas his payment was not in respect of past services. It is, however, clear from the judgement that Mr Randall was also giving up his rights to future payments of commission and, indeed, that is what the agreement said. The payment cannot be regarded as compensation only in respect of past services.

100. The Court of Appeal case *Hamblett v Godfrey* [1987] 1 WLR 357 considered when a payment is "from" the employment. Miss Hamblett was employed at GCHQ. Because of the sensitive nature of the work, the conditions of employment at GCHQ were varied to exclude membership of a trade union and to exclude certain statutory rights under the employment protection legislation. The employees had the choice of remaining in their employment at GCHQ, in which case they would be paid £1,000 in recognition of the loss of rights, or to be transferred to another post within the civil service. Miss Hamblett chose to remain and was paid her £1,000. The question was whether this was an emolument "from" her employment and it was held that it was. Purchas LJ analysed the position as follows:

> "So, in my judgment, the approach that the court should take, and, indeed, that Knox J. did in fact 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. …
>
> 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. …

> This payment is rightly to be assessed under Schedule E and the provisions of section 181 of the Act of 1970."

101. Neill LJ agreed in the following terms:

> "It is plain that the taxpayer received her payment as a recognition of the fact that she had lost certain rights as an employee, and by reason of the further fact that she had elected to remain in her employment at G.C.H.Q. Accordingly, if I may adopt the language of Lord Radcliffe in the passage I have referred to, the payment to the taxpayer was made in return for her being and continuing to be an employee at G.C.H.Q., or to use the words of Viscount Simonds, "the payment accrued to the taxpayer by virtue of her employment." 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 Mr. Mathew in the course of his cogent submissions that the rights lost by the taxpayer were mere personal rights… With respect, I find it impossible to accept this argument. As the 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."

102. This case makes clear that a payment can be an emolument "from" the employment where it is made in the context of the employer/employee relationship for changes in the conditions of employment. There is no requirement that the payment has to "represent" any earnings or allowances which might have arisen in the future from future service. It is sufficient if the employee receives a payment for giving up rights, as opposed to money, which arise out of the employment relationship.

103. The final case to which Mr Carey took me was the Court of Appeal decision in *Kuehne + Nagel Drinks Logistics Ltd and others v Revenue and Customs Commissioners* [2012] STC 840. This case is also concerned with the concept of emoluments being "from" the employment and considers the effect of a duality of purpose on the treatment of a payment. Certain employees of Scottish & Newcastle UK Ltd were transferred to Kuehne + Nagel. Kuehne + Nagel's pension scheme was not as good as that of Scottish & Newcastle and the transferred employees were concerned about it and threatened industrial action. Scottish & Newcastle agreed to fund payments of £4,800 to each employee. The question arose as to whether the payments were taxable earnings "from" the employment.

104. Mummery LJ considered whether the FTT had erred in finding that the payment was linked to the employment, even though it was also compensation for loss of pension rights. He said at [44] to [45]:

> "There was a clear finding of fact that the payments were made to avoid industrial action; that the threat of strike action was 'a substantial cause of the payment'; that the payments were in reference to the services of the employees rendered and in the nature of a reward, inducement or incentive to work willingly for the joint venture company in the future. Those facts were sufficient to establish the necessary relevant connection or link between the

> payments and the recipients' employment and to justify the finding of Judge Hellier that the payments were emoluments from the employment.
>
> [45] … there was no error of law in the judge reaching that conclusion, by reason of his having found that the payments were also paid as compensation for pension loss. He was entitled in fact and in law to conclude that the presence of the pension compensation factor in relation to the payments did not detract from his overall conclusion characterising the payments as being in relation to employment services and therefore emoluments from employment."

105. Patten LJ at [54] to [58] observed that if a payment is made for a reason which is substantially connected with an employment, it is taxable as from the employment, even if there is another, non-employment cause. In this case, it was found that the payment was substantially made to avert the possibility of industrial action (the employment cause) even though it was also compensation for the loss of pension rights (the non-employment cause) and was taxable. He went on to say, at [59]:

> "But even if the correct view of the judge's findings of fact is that the loss of pension rights and the threat were equal rather than successive causes of the payments then the same conclusion must, I think, follow. It is impossible in those circumstances to say that the payments were not from the employment even though they were compensatory in nature. If the employment is a substantial and equal cause of the payment, it becomes open to the judge to say that the statutory test is satisfied. The payment is then from the employment even if it is also substantially attributable to a non-employment cause."

106. Mr Carey submitted that the payment made to Mr McAllister was taxable as it was, essentially, replacing the taxable ICT allowance which formed part, and a substantial part, of his remuneration. He argued that it arose "from" the employment.

107. He emphasised that the terms and conditions of the employment were unchanged except for the withdrawal of the allowance which, as in *Cameron* and *Tilley* amounted to an agreement to continue to provide services, even though there was no obligation to provide the services for any specified time. In any event, *Geoghegan*, *Martland* and *Hamblett* demonstrate that there is no need for an agreement to continue to provide services. It is sufficient in the payment is made for changes to the employment contract which involve giving up something which arises out of the employment relationship.

108. In addition, he submitted that the payment was intended to induce the employees in the ICT discipline to remain in employment following the reduction in their salary, even though they had no obligation to do so. The paper considering the options for dealing with the ICT allowance indicated that the NIA was concerned that staff should not be demotivated by the withdrawal of the allowance. Mr Carey suggested that one could infer, because of the importance of the ICT role, that the NIA was concerned that the service provided should not be disrupted by people becoming demotivated and/or leaving. The employer's motive in making the payment was to maintain good staff relations and avoid disruption, which *Geoghegan* and *Kuehne + Nagel* indicate has a sufficient employment context to make the payment "from" the employment.

109. Dealing with the second point first, the trigger for the negotiations to remove the ICT allowance was the concern about the possibility of equal pay claims, but that was not the reason for the payment. The evidence indicated that the negotiations between the NIA and NIPSA had been going on for several years and that NIPSA had "strongly objected" to the proposals for the withdrawal of the allowances. There was clearly a concern in the Commission that it would

be unwise to act without the agreement of the trade union. Although possibly relevant parts of the 18 February 2015 paper were redacted, it was still possible to see that there was concern about options which might demotivate staff which would have a resultant impact on the provision of services. I infer that it was hoped that the payment of compensation would help to keep staff motivated to provide the necessary level of service although it was acknowledged that there might still be a negative impact on the morale of individual members of staff even if they reached a collective agreement with NIPSA.

110. In fact, Mr McAllister's evidence was that staff did become demotivated, some left and it was difficult to fill vacant posts. He himself had looked at other possible jobs, but he wished to remain in the public sector and he could not find a suitable alternative post at the time and so he remained in his job.

111. Having considered the evidence, I find that the NIA's reason for making the lump sum payments was to compensate the employees for the withdrawal of the ICT allowance and thereby encourage the ICT staff to remain and provide the necessary services. Even if this strategy was not entirely successful, it is clear that the payments were made in the context of the employment relationship. They were paid by reason of the employment and in return for agreeing to a change in the terms and conditions of the employment. It follows that the payment was "from" the employment which is sufficient to make it an emolument of the employment.

112. The position is even clearer when one considers that the lump sum was, in effect, a replacement for the ICT allowance which was being forgone.

113. Mr McVeigh made much of the fact that the payment could not be a precise calculation of the value of the future ICT allowances forgone and that it was not an adequate compensation for what had been lost.

114. He described the formula used to calculate the compensation as "a mish-mash of figures which bore no resemblance to the economic loss which Mr McAllister suffered". He did not consider there was any logic to the computation.

115. He pointed out that Mr McAllister was potentially giving up more than 30 years' worth of allowances (if he remained in post until retirement) for a figure which represented only about eight years' purchase. The removal of the allowance reduced Mr McAllister's pensionable pay, so reducing the employer's contributions to his pension scheme and, ultimately, the pension itself. Further, as the lump sum was all paid in a single tax year, it pushed Mr McAllister into a higher tax bracket which reduced the net value of the payment to Mr McAllister.

116. Whilst Mr McVeigh's comments on the economic loss are true, they do not affect the character or nature of the payment. The payment was not intended to be, and could not be, an accurate reflection of the amount of allowances given up, not least because there was no obligation to remain in employment and so no-one could say how much might be paid in the future by way of ICT allowances. However, the starting point was the amount of the allowance. It was multiplied by the years to retirement to find an estimate of the maximum amount which might have been paid in the future and that figure was then reduced to reflect the fact that the longer the period to retirement, the less likely it was that an employee would remain in employment for that period. That sum was then adjusted by a further additional factor, presumably negotiated by NIPSA.

117. It is quite clear that the lump sum paid as compensation for the withdrawal of the ICT allowance was referable to future payments of the ICT allowance. It was intended to be a replacement for those payments, which would have been taxable emoluments of the employment if they had continued to be paid. It was paid solely for a change in the terms and conditions of Mr McAllister's contract of employment which remained exactly the same except

for his entitlement to the ICT allowance. The lump sum is accordingly a taxable emolument of Mr McAllister's employment.

118. The authorities referred to above amply support this conclusion. They also show that it does not matter that there is no obligation to continue in the employment after the compensation is paid and that it is not a requirement that the amount of the compensation is an actuarial calculation of the precise amount of remuneration forgone as a consequence of the change in the terms and conditions of the employee's employment.

DECISION

119. For the reasons set out above, I have concluded that the lump sum paid to Mr McAllister for giving up his ICT allowance was an emolument of his employment within section 62 ITEPA and is accordingly subject to income tax.

120. I therefore dismiss the appeal.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

121. 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.

MARILYN MCKEEVER
TRIBUNAL JUDGE

Release date: 23 June 2021