INCOME TAX - Schedule E – payments received by Appellant from employer – whether received in consideration or in consequence of or in connection with termination of employment – yes - whether paid in respect of restrictive undertakings given in connection with employment - appeal dismissed - ICTA 1988 Ss 148, 188 and 313

THE SPECIAL COMMISSIONERS

APPELLANT Appellant: use right arrow to move to starting point after this box Appellant

- and -

H M INSPECTOR OF TAXES

Respondent

SPECIAL COMMISSIONER : DR A N BRICE

Sitting in private in London on 11 October 2000

The Appellant in person

The Respondent in person

ANONYMISED DECISION

The appeal

1. The Appellant appeals against an amendment of self assessment dated 21 October 1999 which taxed as income from his employment sums received by him from his employer when his employment terminated in December 1997.

2. The Inland Revenue were of the view that the sums paid to the Appellant were paid in consideration or in consequence of or in connection with the termination of the Appellant's employment, or alternatively, were paid in respect of restrictive undertakings given in connection with the Appellant's employment.

The legislation

3. The legislation relating to sums paid in consideration or in consequence of or in connection with the termination of employment is contained in Sections 148 and 188 of the Income and Corporation Taxes Act 1988 (the 1988 Act). These sections were amended in 1998 in relation to payments received on or after 6 April 1998. The payment at issue in this appeal was received in December 1997. At that time the relevant parts of section 148 provided:

"148. Payments on retirement or removal from office or employment

(1) Subject to the provisions of this section and section 188, tax shall be charged under Schedule E in respect of any payment to which this section applies which is made to the holder or past holder of any office or employment, ... whether made by the person under whom he holds or held the office or employment or by any other person.

(2) This section applies to any payment (not otherwise chargeable to tax) which is made, whether in pursuance of any legal obligation or not, either directly or indirectly in consideration or in consequence of, or otherwise in connection with, the termination of the holding of the office or employment or any change in its functions or emoluments ... ."

4. At the relevant time the relevant parts of section 188 provided:

"188 Exemptions from section 148 ...

(4) Tax shall not be charged by virtue of section 148 in respect of a payment of an amount not exceeding £30,000.00 ... and ... in the case of a payment which exceeds that amount shall be charged only in respect of the excess."

5. The legislation relating to sums paid in respect of the giving of a restrictive undertaking in connection with employment is contained in section 313 of the 1988 Act which provided:

"313. Taxation of consideration for certain restrictive undertakings

(1) Where an individual who holds, has held, or is about to hold, an office or employment gives in connection with his holding that office or employment an undertaking (whether absolute or qualified, and whether legally valid or not) the tenor or effect of which is to restrict him as to his conduct or activities, any sum to which this section applies shall be treated as an emolument of the office or employment, and accordingly shall be chargeable to tax under Schedule E, for

the year of assessment in which it is paid.

(2) This section applies to any sum which-

(a) is paid, in respect of the giving of the undertaking or its total or partial fulfilment, either to the individual or any other person; and

(b) would not, apart from this section, fall to be treated as an emolument of the office or employment."

The issues

6. The Appellant instituted appeals before the Industrial Tribunal. One such appeal was settled on the basis that it would be withdrawn for the sum of £20,000.00 and that the Appellant would leave his employment on voluntary grounds in consideration of which the employer would pay an immediate pension and, in addition to the normal lump sum benefits available under the employer's premature retirement benefit scheme, an additional lump sum to bring the total to £180,000.00. (That additional lump sum amounted to £65,684.20 and is the amount at issue in this appeal.) The settlement also contained a confidentiality agreement and an agreement by the Appellant not to issue any further proceedings.

7. The Appellant argued that the additional lump sum was consideration for the confidentiality agreement and the agreement not to issue any further proceedings and was thus payment for loss of his civil and human rights and was not taxable. The Inland Revenue argued that the additional lump sum was paid in connection with the termination of the Appellant's employment and so was taxable under section 148 subject to the exemption in section 188.

8. Alternatively, the Inland Revenue argued that, if the additional lump sum was consideration for the confidentiality agreement and the agreement not to issue any further proceedings, then it was paid in respect of the Appellant's giving restrictive undertakings in connection with his employment and as such was taxable under section 313.

9. Finally the Appellant argued that the Inland Revenue had agreed in correspondence that the additional lump sum should not be taxable and that it was unfair to reverse that decision.

10. Accordingly, the issues for determination in the appeal were:

(1) whether the additional lump sum of £65,684.20 was paid in consideration or in consequence of or in connection with the termination of the Appellant's employment and so

taxable under section 148 (as argued by the Inland Revenue) or whether that sum was consideration for the confidentiality agreement and the agreement not to issue any further proceedings (as argued by the Appellant); or,

(2) alternatively, if the additional lump sum was paid for the confidentiality agreement and the agreement not to issue any further proceedings, whether it was paid in respect of the Appellant's giving restrictive undertakings in connection with his employment and thus taxable under section 313 (as argued by the Inland Revenue) or whether it was payment for the loss of the Appellant's civil and human rights and therefore not taxable (as argued by the Appellant); and

(3) whether the Inland Revenue had agreed in correspondence that the additional lump sum should not be taxable and if so, whether that decision could be reversed.

The evidence

11. Two agreed bundles of documents were produced by the parties. The bundles contained a statement of agreed facts. The bundles had been prepared by the Inland Revenue but also contained the documents relied upon by the Appellant. The Appellant did not call any witnesses to give oral evidence on his behalf at the hearing of the appeal. Neither did the Appellant give oral evidence on his own behalf. At the conclusion of the hearing I reminded the Appellant that the burden of proof was on him and that the only evidence before me was in the agreed bundles of documents. The Appellant accepted that position.

The facts

12. From the evidence before me I find the following facts.

The Appellant and the employer

13. At all relevant times the Appellant was employed by the employer.

14. The employer, in agreement with the trade unions, operated a standard redundancy and premature retirement scheme which applied to all employees leaving on the grounds of redundancy or premature retirement. Under the scheme employees became entitled to a pension and a lump sum the amounts of which depended upon age at departure and the number of years of service.

The Appellant's appeals to the Industrial Tribunal

15. The Appellant had a number of disputes with the employer about alleged racial discrimination and three of these disputes were the subject of appeals to the Industrial

Tribunal.

16. The first appeal was lodged in 1993 and on 12 August 1994 the Appellant won that appeal and was awarded damages of £5,000.00.

17. In late 1994, arising out of the settlement of the first appeal, the Appellant lodged his second appeal before the Industrial Tribunal (the second appeal). This appeal alleged race discrimination and victimisation on the ground that the Appellant had been overlooked for promotion whilst the first appeal was progressing.

18. In 1996 the Appellant lodged his third appeal before the Industrial Tribunal (the third appeal) also alleging race discrimination.

19. On 4 November 1996 the Employment Appeals Tribunal upheld the second appeal and referred the matter back to the Industrial Tribunal to determine damages.

20. In 1997, whilst the third appeal was progressing, the Appellant also pursued, through the employer's internal grievance procedure, allegations of race discrimination in respect of the employer's selection procedures and his failure to obtain promotion in January 1997.

21. Also in 1997 the Appellant was investigated under the employer's disciplinary procedure for alleged remarks made against other management colleagues.

22. The third appeal was not heard by the Industrial Tribunal but became the subject of negotiations between the Appellant and his employer in the presence of the Advisory, Conciliation and Arbitration Service (ACAS). As a result of those negotiations an agreement was reached on 27 March 1997 in the following form:

"The Applicant agrees to withdraw the third appeal on payment by the Respondent [the employer] of £30,000 in full and final settlement of his claim. In consideration of the payment of £30,000 the Applicant also agrees to withdraw any grievances or complaints currently notified to the employer. The Respondent agrees to terminate the current disciplinary investigation against the Applicant when the Applicant gives a written apology to his management colleague.

Payment of the £30,000 will be made once the Applicant and his solicitors have signed the separate COT3/Compromise Agreement related to the second appeal and the Appellant's severance agreement."

23. On 23 April 1997 the Industrial Tribunal issued an Order that the Appellant and the employer had agreed to

settle the claim on the third appeal on terms set out in writing and lodged with that Tribunal.

The severance agreement

24. On 2 June 1997 the Appellant and the employer entered into an agreement, which was called a severance agreement, in the following form:

"The Agreement below relates to the Appellant's severance from the employer on grounds of voluntary redundancy and in connection with his withdrawal of the second appeal.

1. In consideration of withdrawal of the second appeal the Company will pay £20,000.

2. The Appellant agrees to leave the Company on voluntary redundancy grounds with effect from 31 March 1998 (or earlier on one month's notice by the Appellant and/or commencement of alternative employment.)

3. In consideration of the Appellant's voluntary termination the Company will pay:

3.1 An immediate pension with effect from 1 April 1998 (or earlier as specified above) in accordance with the Company's premature retirement provisions. A statement of these projected benefits is attached. (To follow).

3.2 In addition to the uncommuted lump sum benefits available under the PRCS terms the Company will pay an additional lump sum compensation to bring the total lump sum payment on severance to £180,000.

4. The Company will provide suitable outplacement services to be agreed with the Appellant and will continue to fund and provide such support until the Appellant secures suitable alternative employment.

5. The Appellant agrees to maintain absolute confidentiality in respect of the details of this settlement with the exception of his financial and legal advisers and his immediate family.

6. The employer agrees to provide suitable and positive references to prospective employers on request from such employers.

7. The Appellant agrees not to issue any further proceedings whatsoever against the employer or any of their employees with the exception of any claims arising under this agreement or in respect of personal injury or pension rights. The employer also agrees that this settlement is in satisfaction of all or any claims against the

Appellant."

25. On 19 June 1997 the Advisory, Conciliation and Arbitration Service recorded that the second appeal had been settled.

The Appellant's retirement

26. On 30 October 1997 the Appellant wrote to the employer as follows:

"With further reference to my Severance Agreement with the employer reached at ACAS earlier this year, I give one month's notice that I wish to take premature retirement from the employer from my birthday on 5 December 1997.

I wish to take up a new appointment as Commercial Manager from 3 November 1997. Therefore, I request you to please release me from that date."

27. On 24 November 1997 the Pensions Administration Supervisor of the employer wrote to the Appellant sending him details of the estimated benefits and options available to him. The letter contained the following paragraph:

"Under the terms of the severance agreement you will receive a lump sum which will bring the total compensation lump sum to £180,000.00. You will note that the total lump sums shown on the attached estimate show a lump sum payment of £114,315.80 plus a balance of £65,684.20 bringing the total lump sum to the above figure of £180,000.00. You should be aware that this quotation is based on the salary details currently available and it is likely that the figures will require amendment once your final salary details are known."

28. Sent with the letter of 24 November 1997 was a schedule of estimated benefits dated 20 November 1997. The figures included in that schedule did not reflect the figures mentioned in the letter. Another schedule dated 28 November 1997 was prepared and included the following section:

"COMPENSATION SCHEME – ESTIMATED BENEFITS

1) Compensation equal to 6 months pay £21,261.50

PLUS

2) a) Lump sum compensation £93,054.30

plus additional lump sum compensation £65,684.20

or

b) Annual compensation £ 4,281.99 p.a.

and

Lump sum minimum £75,817.71 (inclusive of ex gratia sum)

As your total lump sum compensation exceeds the £30,000 tax-free limit, the excess will be due for tax at your highest marginal rate. Please note that this also applies to your payment in lieu of notice and ex-gratia awards. These compensation benefits are provided by your employer."

29. The first two amounts of £21,251.50 and £93,054.30 together total £114,315.80. The additional lump sum of £65,684.20 brings that amount to £180,000.00. It is the additional lump sum of £64,684.20 which is in issue in this appeal.

30. The Appellant retired on 5 December 1997.

31. Of the total of £180,000.00 the sum of £84,925.00 was taken in the form of a pension and the balance of £95,075.00 was paid by the employer to the Appellant as a lump sum after deduction of tax which took into account the exemption of £30,000.00 provided by section 188.

The Appellant's claim for a refund of the tax deducted

32. On 6 December 1997 the Appellant wrote to the employer. He disputed some of the figures and also stated that in his view the additional lump sum compensation should be tax free. The Appellant wrote to the Inland Revenue on 25 January 1998 and said that over and above the normal compensation under the employer's voluntary premature retirement scheme he had received an additional compensation payment of £65,684.20. This was in return for the cessation of the dispute procedure before the Industrial Tribunal; his refraining from further applications to the Industrial Tribunal; and the maintenance of confidentiality about the settlement and other matters. He continued that, as the payment was not made because of his employment it should be tax free and, as the employer had erroneously deducted tax, he claimed a refund of the tax which amounted to £15,782.40. Correspondence followed and on 7 June 1998 the Appellant applied for a post-transaction ruling.

33. On 22 August 1998 the Appellant sent further information to the Inland Revenue and argued that the lump sum at issue in the appeal included a component for his agreeing not to pursue the 1997 internal grievance before the Industrial Tribunal; he said that his entitlement to bring the case arose from the violation of his human rights and not from his employment and by not bringing the case he had forgone the possibility of damages and

publicity. On 29 September 1998 the Appellant sent his self assessment return showing his taxable lump sum as nil.

The views of the employer

34. Meanwhile on 20 August 1998 the Inland Revenue wrote to the Pensions Department of the employer asking for information about the compensation paid to the Appellant. A reply was sent on 16 September 1998 saying that the total compensation payment was £98,618.90 made up of 6 months premature retirement pensionable pay (£21,261.50), gross annual compensation payment (£73,813.82) and payment in lieu of notice (£3,543.58). Tax on the excess over £30,000 at 23% had been deducted amounting to £15,782.14. On 20 November 1998 the Inland Revenue wrote to the Appellant and the letter contained the following paragraph:

"...I can now inform you that any part of the termination payment which related to compensation for racial discrimination in respect of your non-promotion will not be taxable under section 19 ICTA 1988 or section 148 ICTA 1998. It will therefore not be taxable at all and any tax deducted by your former employer for this will be repayable."

35. However, the letter also said that the Inland Revenue were having difficulty in reconciling the figures provided by the Pensions Department and would make further enquiries. Further enquiries were made and on 10 December 1998 the Pensions Department sent the Inland Revenue a copy of a memorandum dated 8 December 1998 from the Head of Personnel of the employer. That memorandum read:

"The severance agreement is very clear on this issue. Para. 1 was the overall compensation of £20,000 which relates to the IT case in respect of racial discrimination ... . Para 3.2 is an additional lump sum compensation "to bring the total lump sum payment on severance to £180,000." Therefore the £180,000 was compensation for loss of office and is therefore liable to tax, in my opinion under normal Inland Revenue rules i.e. apart from the first £30,000."

36. On 31 January 1999 the Inland Revenue sent the Appellant a self assessment statement of account showing a credit balance of £14,570.45. However, on 4 February 1999 the Inland Revenue wrote to the Appellant to say that the return submitted in September 1998 had not been processed and that no repayment would be made until the matter of the termination payment had been finally resolved. On the same day the Inland Revenue wrote to the employer asking for further information. This was provided on 15 February 1999 in a letter which said that, at the time the Appellant left, there were two settlements. The first was a settlement for £30,000 to settle the third appeal, the

subsequent internal grievances and the disciplinary investigation and the payment of £30,000 was conditional on signing the separate agreement relating to the second appeal. The second settlement was for £20,000 for the withdrawal of the second appeal and a severance payment of £180,000 as detailed in the severance agreement.

The correspondence leading to the disputed decision

37. On 31 March 1999 the Inland Revenue wrote to the Appellant. The letter set out the information received from the employer and stated that no part of the £180,000 related to anything other than severance and as such was taxable under section 148. The Appellant replied on 2 April 1999 stating that in his view the ex gratia sum of £65,684.20 was not taxable. The Inland Revenue replied on 7 May 1999 and part of that letter read:

"Under the severance agreement you received £180,000 of which, as you say, £114,315 was due under the retirement compensation scheme. There is nothing in the documentation I have seen which sets out what the balance of the £180,000 was paid for. There was no entitlement to it under your contract so it cannot be taxed under section 19 ICTA 1988.

You say it was because of points 5 and 7 of the severance agreement. I am not convinced that this was necessarily the case. Points 5 and 7 are effectively restrictive covenants. Any part of the severance payment relating to them would strictly be taxable under section 313 ICTA 1988".

38. On 16 May 1999 the Appellant wrote to the Inland Revenue and suggested that £5,000.00 of the payment of £65,684.20 which he had received should be treated as for the restrictive covenant in paragraph 5 of the severance agreement and that the remainder should be attributable to paragraph 7 of the severance agreement. On 17 June 1999 the Inland Revenue accepted that £5,000.00 should be taxable under section 313 as consideration for the restrictive covenant in paragraph 5 of the severance agreement but also stated that the balance of the sum received was taxable under section 148. Further correspondence followed.

The disputed decision

39. On 21 October 1999 the Inland Revenue wrote to the Appellant with an amendment of self assessment. The letter said that a revised calculation was attached. This showed the amount of £118,138.00 as income from employment and that amount included the £65,684.20 paid as additional lump sum compensation. The total tax and national insurance contributions due amounted to £13,183.95. On the same day the Appellant appealed

against that amendment of self assessment.

40. It was not disputed by the Inland Revenue that the relationship between the Appellant and the employer was such that neither were disposed to grant anything to the other without full consideration.

Reasons for decision

41. I consider separately each of the issues for determination in the appeal.

Issue (1) – Is the additional lump sum taxable under section 148?

42. The first issue in the appeal is whether the additional lump sum of £65,684.20 was paid in consideration or in consequence of or in connection with the termination of the Appellant's employment and so taxable under section 148.

43. The Appellant argued that that sum was not taxable. Paragraphs 2 and 3.1 of the severance agreement dealt with his departure from the employer and paragraphs 3.2 and 7 dealt with his agreement not to proceed with the second appeal. The additional lump sum payment mentioned in paragraph 3.2 was compensation for the agreements in paragraphs 5 and 7 and was not compensation for loss of office. He cited Chappell & Co. Ltd and Others v The Nestle Co. Ltd and Others [1959] 2 ALL ER 701 at 712H as authority for the view that a contracting party could stipulate for what consideration he chose. He cited Du Cros v Ryall (1935) 19 TC 444 as authority for the view that an agreement between the parties should not be disturbed. The Appellant also argued that a payment could be apportioned and he cited Wales v Tilley (1942) 25 TC 136; Henley v Murray (1950) 31 TC 351 at 108; and Mairs v Haughey (1993) 66 TC 273 at 280 C,G and H and 342G.

44. The Respondent argued that the additional lump sum compensation was taxable under section 148(2) as a payment made in consideration or in consequence of or in connection with the termination of the Appellant's employment. The severance agreement of 2 June 1997 was clear. The sum of £20,000.00 had been paid for the withdrawal of the second appeal. The Appellant agreed to voluntary redundancy and paragraph 3 made it clear that all of the £180,000.00 was paid in connection with the voluntary termination. He relied upon the words of Sir Raymond Evershed MR in Henley v Murray at 365 to support the view that a court was not entitled to disregard the legal result actually produced by the parties. The Respondent further argued that the severance agreement did not provide for any value to be placed on paragraphs 5 and 7 and there was no evidence to support the conclusion that a value should be placed on either paragraph. Paragraph 5 was normal for that type of agreement and

paragraph 7 also contained an agreement by the employer that the settlement covered all its claims against the Appellant. Further, the memorandum from the employer of 8 December 1998 stated that it was the view of the employer that the whole of the £180,000.00 was compensation for loss of office. That view was repeated in the letter from the employer of 15 February 1999. The agreement of 27 March 1997, relating to the settlement of the third appeal, together with the severance agreement supported the conclusion that in total £50,000.00 had been paid to the Appellant to settle two appeals and that £180,000.00 was paid for voluntary redundancy. The Respondent argued that Chappell did not support the Appellant's contention that a value had to be attached to paragraphs 5 and 7 of the severance agreement. He accepted that Wales v Tilley, Mairs v Haughey and Du Cros were authority for the view that one sum could be apportioned but only if it covered two separate and distinct elements and in this appeal the whole of the £180,000.00 had been paid for severance.

45. In considering the arguments of the parties I first consider the authorities cited to see what principles they establish.

46. In Du Cros (1935) an employer repudiated a service agreement and proceedings by the employee for arrears of salary and damages were settled by the payment of one sum as agreed damages. The General Commissioners decided that only part of that sum was income but the High Court held that the whole of the sum was damages for cancellation of the service agreement and not assessable to tax. At page 453 Finlay J held that there was no material before the General Commissioners which would support their view. Wales v Tilley (1942) concerned a lump sum payment made to an employee in return for the employee releasing the employer from existing obligations to pay a higher salary and a pension. The House of Lords held that the lump sum could be apportioned and that only so much of the payment as represented the sum paid to release the employer from the obligation to pay a higher salary was assessable to tax. In Henley v Murray (1950) a managing director resigned and received a sum representing remuneration to which he would have been entitled from the date of his resignation to the end of his contract. The contemporaneous documents indicated that the amount was paid as compensation for loss of office. At page 365 Sir Raymond Evershed MR said:

"I quite agree that language which the parties may use, such as "compensation for loss of office" is not the determining factor when you have to decide what in truth was the bargain, and that the duty of the Court is to see what in substance and truth the bargain was and not to be blinded by some formulae which the parties may have

used."

47. Chappell (1959) concerned the infringement of copyright. Under regulations a manufacturer of records was obliged to inform the copyright owner of an intention to make records and the selling price. A record manufacturer gave notice that he intended to sell records at 1s 6d each. In fact they were sold to a chocolate manufacturer for 4d each so that the chocolate manufacturer could sell them to the public for 1s 6d each. However, the chocolate manufacturer also required an intending purchaser to supply three chocolate wrappers as well. The wrappers had no value and when received were thrown away. The House of Lords held that the money paid by the purchasers was not the entire consideration for the records and the notice was defective because it did not state the non-pecuniary consideration. At page 712H, in a passage relied upon by the Appellant, Lord Somervell said that it was irrelevant that the wrappers were of no value; a contracting party could stipulate for what consideration he chose.

48. In Mairs (1993) a company was privatised. Each employee was offered one payment. Part of that payment represented a portion of his non-statutory redundancy rights in the old company which were to be discontinued and the other part represented a payment for each year of service with the old company. The House of Lords held that the issue could be resolved by construing the documents or by looking at the substance and reality of the situation; the single sum was paid for two separate considerations, namely the new conditions of employment and the termination of the old redundancy scheme. The latter was not then chargeable to tax.

49. From those authorities I derive three main principles. The first is that it is necessary to construe the documents and other evidence so as to determine the substance and reality of what the payment was paid for. The second is that the parties to an agreement can decide what the payment is for. And the third is that if a single sum is paid for two separate and identifiable considerations then the single sum should be apportioned and each part should be considered separately to see if it is chargeable to tax.

50. Applying those principles to the facts of the present appeal I first consider the documents so as to determine the substance and reality of what the payment was paid for. The payment was made under the severance agreement of 2 June 1997 and so I start with that agreement. The preamble states that the agreement relates to two things, namely, the Appellant's severance from the employer on grounds of voluntary redundancy and his withdrawal of the second appeal. Paragraph 1 assigns the value of £20,000.00 to the withdrawal of the second appeal and paragraph 3 assigns the value of a pension and a total lump sum of £180,000.00 (of which the sum in issue

in the appeal forms part) to the voluntary termination. In my view paragraph 3 makes it clear that in substance and reality the £180,000.00 (including the sum at issue in the appeal) was paid for the voluntary termination. As such it is taxable under section 148.

51. The Appellant argued that paragraphs 5 and 7 had a value and that the sum at issue in the appeal was paid for the agreements in those paragraphs. However, this ignores the fact that the sum at issue in the appeal was paid as a result of paragraph 3 which states specifically that it relates to the voluntary termination. In order to consider the value placed by the parties on paragraphs 5 and 7 it is necessary to view the severance agreement as a whole. The parties placed specific values on the withdrawal of the second appeal (£20,000.00) and the voluntary termination (the pension and £180,00.00). There are then four other agreements in paragraphs 4, 5, 6 and 7. One of these (paragraph 5) is an agreement solely by the Appellant; two (paragraphs 4 and 6) are agreements solely by the employer; and one (paragraph 7) is an agreement by both the Appellant and the employer. No values are placed on any of these agreements. The substance and reality is that the employer entered into the agreements in paragraphs 4, 6 and 7 in return for the Appellant's entering into the agreements in paragraphs 5 and 7. That is what the parties to the agreement decided.

52. The conclusion that under the severance agreement the sum at issue in the appeal was paid for the voluntary termination of the Appellant's employment is supported by the subsequent documentation from the employer, namely the letter of 24 November 1997 from the Pensions Administration Supervisor of the employer; the schedule of estimated benefits dated 28 November 1997; and the memorandum of 8 December 1998 from the Head of Personnel of the employer. There is no documentation which supports the Appellant's contention.

53. It is also relevant that all the correspondence about the sum at issue in the appeal was conducted for the employer by its pension department and the benefits were calculated by that department. The payment of the sum of £20,000.00 mentioned in paragraph 1 of the severance agreement must have been dealt with separately. That also points to the conclusion that the sum at issue in this appeal was considered by the employer as part of the payments made for the voluntary redundancy.

54. Having construed the documents I find that in substance and reality the payment at issue in the appeal was paid for the Appellant's voluntary redundancy and that is what the parties to the severance agreement decided the payment was for. Although, if a single sum is paid for two separate and identifiable considerations then the single sum can be apportioned and each part considered

separately to see if it is chargeable to tax, what was paid in this appeal was one single sum which was chargeable to tax under section 148.

55. My decision on the first issue in the appeal is that the additional lump sum of £65,684.20 was paid in consideration or in consequence of or in connection with the termination of the Appellant's employment and so taxable under section 148.

56. That conclusion means that I do not have to consider the second issue but as arguments were put to me I very briefly express my views.

Issue (2) – Was the amount taxable under section 313?

57. The second issue in the appeal is whether, if the additional lump sum was paid for the confidentiality agreement and the agreement not to issue any further proceedings, it was paid in respect of the Appellant's giving restrictive undertakings in connection with his employment and thus taxable under section 313.

58. The Appellant referred to Statement of Practice SP3/96 (termination payments made in settlement of employment claims). That provided that no charge to tax arose under section 313 where there was an agreement to discontinue legal proceedings or not to commence proceedings. That meant that no charge under section 313 arose in respect of the undertaking in paragraph 7 of the severance agreement. On 16 May 1999 he had suggested that, of the total amount of £64,684.20, £5,000.00 related to the undertaking in paragraph 5 and £60,000.00 related to the undertaking in paragraph 7. Alternatively the Appellant argued that section 313 did not apply because the payment for the undertakings was paid in respect of the violation of his civil and human rights and was not a payment given in connection with his employment.

59. The Respondent argued that if values were placed on paragraphs 5 and 7 of the severance agreement then those sums should be taxable under section 313. SP3/96 only applied if a settlement did not provide for a value to be attached to an undertaking to discontinue legal proceedings. If a value were to be attached to such an undertaking then SP3/96 would not apply.

60. Statement of Practice SP 3/96 provides:

"1. TA 1988 s 313 imposes a charge under Schedule E on payments made to individuals for undertakings given in connection with an employment, which restrict their conduct or activities.

2. A financial settlement relating to the termination of employment may contain terms whereby the employee

agrees to accept the termination package in full and final settlement of his or her claims relating to the employment, and/or may expressly provide that the employee should not commence or, if already commenced, should discontinue legal proceedings in respect of those claims. These may relate to claims at common law arising from the contract of employment or to claims arising under employment protection or other legislation. The settlement, therefore, seeks to avoid legal dispute or proceedings, for example before a court or an industrial tribunal, in connection with those rights. The termination settlement may also reaffirm undertakings about the individual's conduct or activity after termination which formed part of the terms on which the employment was taken up.

The Inland Revenue will accept that no chargeable value will be attributed under s 313(2) to such undertakings by an employee or former employee.

3. But this does not affect the application of s313 to sums that are attributable to other restrictive undertakings which individuals give in relation to an employment, whether these undertakings are contained in a job termination settlement or otherwise."

61. I have already found that no monetary value was attached by the parties to the severance agreement to the agreements by the Appellant in paragraphs 5 and 7; these agreements were given in consideration for the agreements by the employer in paragraphs 4, 6 and 7. Accordingly it follows that, under SP 3/96, no charge to tax arises in respect of such agreements. However, if a separate monetary value had been placed on the agreements by the Appellant in paragraphs 5 and 7 then it is arguable that that would have amounted to the attribution of chargeable value by the parties to those undertakings with the result that SP 3/96 would not apply.

62. My conclusion on the second issue is that, if the additional lump sum or part of it was paid for the confidentiality agreement and the agreement not to issue any further proceedings, then it might well be that chargeable values were attributed by the parties to such agreements which would prevent the application of SP3/96 leaving the amount to be taxable under section 313.

Issue (3/ – Was there an agreement?

63. The third issue in the appeal is whether the Inland Revenue agreed that the additional lump sum should not be taxable and, if so, whether that decision could be reversed.

64 The Appellant argued that on 7 June 1998 he had requested a post-transaction ruling and that had been given on 31 January 1999 when the Inland Revenue had sent the statement of account showing a credit balance of

£14,570.45. That had been the right decision and the Inland Revenue should not have changed it. He had understood that the letter from the Inland Revenue of 20 November 1998 was an agreement that the additional lump sum would not be taxed.

65. The Respondent argued that at no time had the Inland Revenue agreed that the additional lump sum should not be taxed. The statement in the letter of 20 November 1998 was correct as a matter of law but on the same day the Inland Revenue had requested further information from the employer. Although a statement of account had been sent to the Appellant on 31 January 1999 showing a credit balance, that was based on the Appellant's figures and it had been followed very shortly by the letter of 4 February saying that the matter of the termination payment had not been finally resolved.

66. The statement in the letter of 20 November 1998, that any part of the termination payment which related to compensation for racial discrimination would not be taxable was correct but the letter of 20 November did not state that the payment received by the Appellant would not be taxable. The Inland Revenue did not then have all the information they required on which to reach a decision. Accordingly, I find that the letter of 20 November 1998 did not constitute an agreement that the amount at issue in this appeal should not be taxable. I can understand why the Appellant found the events surrounding the self assessment statement of account sent on 31 January 1999 to be confusing. The Appellant asked for a post-transaction ruling on 7 June 1998 and sent his return in September 1998. After that he received the letter of 20 November 1998 and then the statement of account dated 31 January 1999 showing a substantial credit. It is understandable that the Appellant thought that the Inland Revenue were treating the amount at issue in the appeal as non-taxable. However, the letter of 4 February 1999 did make it clear that the matter of the termination payment had not been resolved.

67. My conclusion on the third issue in the appeal is that the Inland Revenue did not agree that the additional lump sum should not be taxable.

Decision

68. My decisions on the issues for determination in the appeal are;

(1) that the additional lump sum of £65,684.20 was paid in consideration or in consequence of or in connection with the termination of the Appellant's employment and so taxable under section 148; that means that I do not have to decide the second issue but as arguments were put I

express my views which are:

(2) that, if the additional lump sum or part of it was paid for the confidentiality agreement and the agreement not to issue any further proceedings, then it might well be that chargeable values were attributed by the parties to such agreements which would prevent the application of SP3/96 leaving the amount to be taxable under section 313; and

.(3) that the Inland Revenue did not agree that the additional lump sum should not be taxable.

59. The appeal is, therefore, dismissed.

DR A N BRICE

SPECIAL COMMISSIONER

Date of Release: 11th December 2000

SC 3084/2000