



TC01308

Appeal number: TC/10/02754

Income Tax – Schedule E – Employment – Emoluments – Payment in lieu of notice – Payment made under provision in contract of employment – Whether receipt was emoluments or termination payment – Section 7 and Section 63 Income Tax (Earnings and Pensions) Act 2003 - Appeal refused.

FIRST-TIER TRIBUNAL

TAX

ALASDAIR MCDONALD

Appellant

- and -

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

Respondents

TRIBUNAL JUDGE: W Ruthven Gemmell, WS

Sitting in public in 126 George Street, Edinburgh on 29 June 2011

Mr Alasdair McDonald, for the Appellant

Miss Ros Shields instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

- 5 1. Alasdair McDonald (“AM”) appealed against a notice issued under Section 28A(1) and (2) of the Taxes Management Act 1970 issued on 14 January 2009 issued by H M Revenue and Customs (“HMRC”).
2. The amounts at issue were £436.32 in income tax and £229.02 in National Insurance Contributions.
- 10 3. The issue before the Tribunal was whether a payment made in November 2006, together with a payment due in December 2006, were to be treated as payments made in consequence of the termination of employment and, therefore, not taxable or, alternatively, whether a payment for the month of November was taxable as emoluments as being a payment which AM was entitled under his contract of employment and taxable under Section 62 of the Income Tax (Earnings and Pensions) Act 2003 (“ITEPA”).
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Legislation

4. Income Tax (Earnings and Pensions) Act 2003 -

Section 7

20 Meaning of “employment income”, “general earnings” and “specific employment income”

This section has no associated Explanatory Notes

(1) This section gives the meaning for the purposes of the Tax Acts of “employment income”, “general earnings” and “specific employment income”.

25 (2) “Employment income” means -

(a) earnings within Chapter 1 of Part 3,

(b) any amount treated as earnings (see subsection (5)), or

(c) any amount which counts as employment income (see subsection (6)).

30 (3) “General earnings” means—

(a) earnings within Chapter 1 of Part 3, or

(b) any amount treated as earnings (see subsection (5)),

excluding in each case any exempt income.

35 (4) “Specific employment income” means any amount which counts as employment income (see subsection (6)), excluding any exempt income.

(5) Subsection (2)(b) or (3)(b) refers to any amount treated as earnings under—

5 (a) Chapters 7 and 8 of this Part (application of provisions to agency workers and workers under arrangements made by intermediaries),

(b) Chapters 2 to 11 of Part 3 (the benefits code),

(c) Chapter 12 of Part 3 (payments treated as earnings), or

(d) Section 262 of CAA 2001 (balancing charges to be given effect by treating them as earnings).

10 (6) Subsection (2)(c) or (4) refers to any amount which counts as employment income by virtue of—

(a) Part 6 (income which is not earnings or share-related),

(b) Part 7 (share-related income and exemptions), or

(c) any other enactment.

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Section 62

Earnings

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

20 (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

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

(3) For the purposes of subsection (2) “money’s worth” means something that is—

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

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

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

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5. Social Security Contributions and Benefits Act 1992 -

Section 2

Categories of earners

(1) In this Part of this Act and Parts II to V below -

5 (a) “employed earner” means a person who is gainfully employed in Great Britain either under a contract of service, or in an office (including elective office) with emoluments chargeable to income tax under Schedule E; and

10 (b) “self-employed earner” means a person who is gainfully employed in Great Britain otherwise than in employed earner’s employment (whether or not he is also employed in such employment).

(2) Regulations may provide -

15 (a) for employment of any prescribed description to be disregarded in relation to liability for contributions otherwise arising from employment of that description;

20 (b) for a person in employment of any prescribed description to be treated, for the purposes of this Act, as falling within one or other of the categories of earner defined in subsection (1) above, notwithstanding that he would not fall within that category apart from the regulations.

25 (3) Where a person is to be treated by reference to any employment of his as an employed earner, then he is to be so treated for all purposes of this Act; and references throughout this Act to employed earner’s employment shall be construed accordingly.

30 (4) Subsections (1) to (3) above are subject to the provision made by section 95 below as to the employments which are to be treated, for the purposes of industrial injuries benefit, as employed earner’s employments.

35 (5) For the purposes of this Act, a person shall be treated as a self-employed earner as respects any week during any part of which he is such an earner (without prejudice to his being also treated as an employed earner as respects that week by reference to any other employment of his

Section 3

“Earnings” and “earner”

(1) In this Part of this Act and Parts II to V below -

(a) “earnings” includes any remuneration or profit derived from an employment; and

(b) “earner” shall be construed accordingly.

5 (2) For the purposes of this Part of this Act and of Parts II to V below other than those of Schedule 8—

(a) the amount of a person’s earnings for any period; or

(b) the amount of his earnings to be treated as comprised in any payment made to him or for his benefit,

10 shall be calculated or estimated in such manner and on such basis as may be prescribed.

(3) Regulations made for the purposes of subsection (2) above may prescribe that payments of a particular class or description made or falling to be made to or by a person shall, to such extent as may be prescribed, be disregarded or, as the case may be, be deducted from the amount of that person’s earnings.

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Cases Referred To

EMI Group Electronics Limited v Coldicott (H M Inspector of Taxes), Court of Appeal, 1999, No. 3591.

20 The Facts

6. The following facts were found:-

7. AM was employed by J T Inglis & Sons Ltd of Dundee as a financial controller under a contract of employment which began on 1 September 2005.

8. The contract was never signed by AM but he worked for the company in accordance with its terms and conditions.

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9. The contract included a provision that “on termination of employment the monetary value of holidays due will be calculated as above and paid to you if time off is not convenient”. The notice of termination of employment, on the basis that AM worked for a period of more than one month, which it was confirmed that he did, was four weeks notice. The employer was entitled in its absolute discretion to require AM not to attend at work and/or not to undertake any of your duties during any period of notice (hereinafter referred to as “garden leave”).

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10. AM confirmed that he did work through the period of November except for occasions when he attended interviews of other jobs.

35 11. J T Inglis & Sons Limited went into administration on 14 December 2006 and the payment that AM was due for December 2006 was never paid.

12. On 30 October 2006, J T Inglis & Sons Limited or rather the Beale Group of which J T Inglis & Sons Limited was a member, wrote to AM advising AM that he was being made redundant as there was no longer a full time requirement for his role.

5 13. The letter said “it has been agreed that you are entitled to one month’s notice from today’s date and if you wish you can take garden leave during your notice period. It has also been agreed you will be paid November salary and December salary in Gross, (i.e. not subject to tax or NIC) as a full and final settlement for loss of office”.

10 14. A joint administrator, an employee of KPMG LLP, wrote to AM on 6 February 2007 in relation to AM’s enquiry about his agreement with the company stating “I understand that the salary paid to you in November 2006 was subject to tax and NIC. You should contact the Inland Revenue about having these amounts refunded”.

15 15. HMRC were requested to carry out a review of the decision and issued a letter on 6 August 2009.

16 16. The review upheld the decision of 14 January 2009 the Section 28 Notice on the basis that HMRC felt that payments made to an employee in consideration or in consequence of or otherwise in connection with the termination of their employment were chargeable to tax under Section 401 of the ITEPA. It said that broadly speaking payments of less than £30,000 were not taxable.

20 17. The letter went on “you were given notice of termination of your employment in the letter of 30 October 2006. That letter gave you one month’s notice and told you you could take garden leave during your notice period. You were entitled to that period of notice under your contract of employment and the salary you were paid for that month was not therefore a payment made in consequence of the termination of your employment. It was a payment you were entitled to under your contract of
25 employment and is taxable as your normal salary under Section 62 of the Income Tax (Earnings and Pensions) Act 2003”.

18. The review noted that the December payment was in connection with the termination of employment and, as it was less than £30,000, was not taxable. It was, of course, not paid to AM.

30 **Submissions by AM**

19. AM says that he relied on the letter of 30 September 2006 as an amendment of the contract of employment, which he had never signed, and confirmation of the treatment of these payments.

35 20. AM says that the issue of garden leave did not arise as in fact he worked for the company during the month of November.

21. AM also relied on the letter from KPMG LLP which suggested that the tax for the November payment should be refunded as it had already been paid.

22. AM's view was that both payments for November and December, regardless of whether they were paid or not, were in termination of his employment and, accordingly, should not be taxable nor suffer National Insurance Contributions and that the appeal should be allowed.

5 **HMRC's Submissions**

23. HMRC say that the November salary payment is taxable as it was a payment AM was entitled to under his contract of employment.

24. HMRC say this meets the definition of earnings stated at Section 62 of the ITEPA.

10 25. HMRC refer to the contract of employment which contains the notice period of four weeks and also to the provisions of the letter of termination of 30 October 2006 which raises the issue of garden leave.

26. HMRC say that garden leave is a contractual payment and, therefore, should be taxable.

15 27. HMRC say that the employer's letter cannot contractually change the position as defined in the Tax Statutes.

20 28. HMRC refer to the case of *EMI Group Electronics Limited* where the Court of Appeal distinguished a redundancy payment which "in part" is to relieve an employee from the hardship consequent upon being unemployed – and a payment in lieu of notice. Notice of intention to terminate –or a payment in lieu of notice – is not intended to relieve the hardship consequent on becoming unemployed. It is no substitute for redundancy payment. Indeed, it is something to which the employee is entitled to in addition to redundancy payment".

29. HMRC say the appeal should be dismissed.

Reasons for the Decision

25 30. The Tribunal were sympathetic to AM's position whereby on 30 October he was given one month's notice and a letter from his employer stating that he would receive a further one month's salary, notionally for December, as compensation for termination of his employment, which in fact was never paid, as the company went into administration in mid December 2006.

30 31. The Tribunal was of the view that, notwithstanding what was written in the letter, the payment for the month of November was earnings as defined by Sections 7 and 62 of the ITEPA and Sections 2 and 3 of the Social Security Contributions and Benefits Act 1992 and was, therefore, liable to both Income Tax and National Insurance Contributions.

35 32. This is in line with the Court of Appeal Opinion that a payment in lieu of notice is no substitute for, nor is, a redundancy payment. It is a contractual right and is, therefore, not a termination payment.

33. The Appeal is accordingly refused.

34. 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.

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W RUTHVEN GEMMELL, WS
TRIBUNAL JUDGE
RELEASE DATE: 8 JULY 2011

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