



TC02359

Appeal number: TC/2010/00600

TYPE OF TAX – income tax – Post Office compensation payment – compensation for loss of business and investment – no – payment for loss of office – yes – partial attribution to previous office holder– no.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

MRS B J PANESAR

Appellant

- and -

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

**TRIBUNAL: JUDGE RACHEL SHORT
DR MICHAEL JAMES**

Sitting in public at Vintry House, Wine Street Bristol on 23 July 2012

Mr B Panesar for the Appellant

**Mr Peter Massey, instructed by the General Counsel and Solicitor to HM
Revenue and Customs, for the Respondents**

DECISION

1. This is an appeal against a closure notice for the 2004 – 5 tax year in respect of
5 the treatment of a sum of £79,577 paid to Mrs Panesar in October 2004 and three
penalty assessments for 2002 – 3 amounting to £353, for 2003 – 4 amounting to £360
and for 2004 -5 amounting to £4417. The original appeal also referred to penalties for
the 2001- 2 period but HMRC have agreed to withdraw this claim on the basis that
there is no tax to pay for that period.

10 2. The original appeals also referred to discovery assessments for the 2001 – 2 and
2002 – 3 periods and a closure notice for the 2003 – 4 tax period. These have now all
been settled on the terms set out in HMRC’s letter of 12 January 2012 and were not
therefore considered by this Tribunal.

15 3. No evidence having been submitted to the Tribunal by the Appellant in respect
of the penalties for the 2002 – 3, 2003 – 4 and 2004 -5 periods, the Tribunal agreed to
adjourn consideration of those matters and continue to hear the appeal concerning the
main matter under consideration, the tax treatment of the £79,577 paid to Mrs Panesar
by the Post Office in October 2004 (the Compensation payment).

20 4. Since the date of this Tribunal the HMRC have withdrawn these penalty
assessments and therefore they are not considered further.

The Facts

5. In October 2004 Mrs Panesar received a payment from the Post Office as part of
the Post Office Closure Scheme, arising from the Post Office “Network Re-Invention
Programme” – (the “NRP”), of £79.577. This was paid into a joint, non business
25 account which was held in the names of Mr and Mrs Panesar. This amount was not
declared in the income tax returns of either Mr or Mrs Panesar for the 2004 – 5 tax
period, or any other period. Mr Panesar had attempted to contact a number of HMRC
offices to obtain clarification of the correct treatment of the payment, but was unable
to get a response from anyone at HMRC, including HMRC’s expert in this area, Miss
30 Bunn, who had retired before any response was made to Mr Panesar’s request.

6. Mrs Panesar took over as sub post mistress of the Coldharbour Road Bristol
branch of the Post Office on 24 October 2001. She took this role on the resignation of
her husband as the sub post master of the same branch. Mr Panesar had been sub post
master since 8 April 1999. Mrs Panesar applied to take over the role on the basis of
35 the standard process, in an “open competition” which any third party applying for the
post would have had to under go. This is set out in the letters from the Post Office to
Mrs Panesar of 2 May 2001 and 15 October 2001.

7. The post office was run from rooms located in the freehold property jointly
owned by Mr and Mrs Panesar at Coldharbour Road. Their business also included a
40 small shop selling items of stationery, which accounted for a relatively small
proportion of their over all earnings.

8. When Mr Panesar took over the Post Office licence in 1999 he paid £30,000 for the goodwill of the business, paid over 25% of his first year's profits by way of an introductory licence fee and spent a further £3,000 on refurbishments to the existing premises, which required significant updating.

5 9. Both Mr and Mrs Panesar were employed under the Post Office standard contract terms, of which the Tribunal were shown a copy. That contract states that the sub- post master is employed as an agent and not as an employee (Clause 1) and that there is no right of compensation for loss of office (Clause 8)

10 10. From 2001 – 2004 the government was considering various options for consolidation of the urban post office network and that culminated in the “Network Re Invention Programme”.

15 11. It was as a result of the NRP that Mrs Panesar received the £79,577 as set out in a letter addressed from the Post Office to her on 20 February 2004 and described as “an offer of compensation” This offer was confirmed by a letter to Mrs Panesar of 18 October 2004 (at folio D17 – 18). The post office at Coldharbour Road was closed on 31 October 2004 under the NRP.

12. In letters of June 2007 and August 2008 the Post Office provided further information in response to Mr Panesar's request about the basis on which the payment to Mrs Panesar had been calculated.

20 13. By a letter of 6 June 2008 HMRC argued that this sum was subject to income tax, save for the first £30,000 and that Mrs Panesar therefore had a further sum of £18,029.46 of tax due for the 2004 - 5 tax year.

The Law

25 14. The relevant legislation is set out in the Income Tax (Earnings and Pensions) Act 2003 at s 401 and s 403.

s.401 (1) *“This Chapter applies to payments and other benefits which are received directly or indirectly in consideration or in consequence of or otherwise in connection with –*

(a) the termination of a person's employment

30 *(b) a change in the duties of a person's employment*

(c) a change in the earnings from a person's employment,

By the person, or the person's spouse or civil partner, blood relative dependant or personal representative”

35 *S 403(1) “The amount of a payment or benefit to which this Chapter applies counts as employment income of the employee or former employee for the relevant year if and to the extent that it exceeds the £30,000 threshold”.*

15. S 5 ITEPA also states that: “*the provisions of the employment income Parts that are expressed to apply to employments apply equally to offices, unless otherwise stated.*”

The Arguments

5 *The Taxpayer’s arguments*

Substance of the Payment is Compensation for loss of business and investment

16. Mr Panesar’s view is that the payment made to Mrs Panesar is not taxable under s 401 because although it was paid at the time when she ceased her role as sub post mistress this does not reflect the true substance of that payment. Its relationship to the
10 termination of this role as a result of the closure of the post office at Coldharbour Road, is incidental, in his words “a loose end”. Mr Panesar memorably used the analogy of someone being taxed for their lottery winnings under s 401 because, having won the lottery, they resigned from work.

17. In Mr Panesar’s view the payment was a payment for the goodwill which arose
15 as a result of the termination of the post office business at Coldharbour Road. It was not a payment for the termination of the business, because that was transferred to other Post Offices in the area. The payment was made to Mrs Panesar in consideration of her agreeing to the specific terms of the Post Office offer of compensation, which had to be agreed prior to the termination of her office. It could
20 not therefore be a payment for the termination of the office itself.

18. The real purpose of the payment, and therefore its tax character, should be taken from the way in which the compensation scheme is described in the many government produced documents discussing the Network Re Invention Scheme. Mr Panesar cited a number of these documents to us including *The House of Commons, Trade and
25 Industry, Seventh Report – The Urban Network Re Invention Process*, dated July 2004, extracts from the House of Commons debates recorded in Hansard for 15 October 2002 considering the Urban Post Office Re Invention Programme and *The House of Commons Trade and Industry Committee Post Office Urban Network Re invention Revisited: Government response to the Committee’s 10th report of Session
30 2003 – 4* (dated 10 February 2005), referring to the fact that in nearly all of them the compensation payable is referred to as a payment in respect of “the loss of business and investment”.

Payment made outside the NRP terms

19. Secondly, Mr Panesar argues that even if payments under the Network Re
35 Invention Scheme could generally be treated as taxable under s 401, the payment to Mrs Panesar was made outside the terms of the NRP. Mrs Panesar was paid more than she was entitled to under the terms of the scheme, given her length of service. (She received 27 months compensation; according to her term of office she should only have received 12). To the extent that the amount of the payment exceeded the
40 amount due under the NRP, it was outside the scope of s 401.

20. In this regard Mr Panesar referred to Appendix 1 of the DTI document of 6 April 2004 setting out the basis on which compensation was to be paid under the NRP, if, as was the case here, the “business value method” of calculation was used. (provided at Folio 98-103)

5 21. That document also sets out the basis of calculation if a “family transfer” situation applies, in which case Mrs Panesar would have been eligible for 27 months compensation, as a result of Mr Panesar having been appointed in April 1999. However, Mr Panesar did not accept that Mrs Panesar’s payment had been calculated on the basis that the transfer from him to her had been a “family transfer” – situation
10 B, citing the fact that there was nothing in the correspondence and documentation relating to Mrs Panesar’s appointment which suggested that this was the case.

22. Mr Panesar claimed that the payment to Mrs Panesar was made as a result of conversations that he had with Sir Tim Stevens in late 2002 and early 2003 where he requested that his term of service should be taken account of in order for them to
15 consider any agreement to the closure of their branch. This was outside the remit of the standard NRP and therefore could not have been made under its terms.

23. Mr Panesar also said that the compensation payment could not have been for loss of office because at the time when it was paid Mrs Panesar had already ceased business. The framework which the Post Office provided as part of the closure,
20 including managing transferring customers to other branches and ensuring that good will was retained, was also more akin to the settlement of a business compensation than payment for loss of office.

24. Mr Panesar also pointed out that under the terms of the standard Post Office contract clause 8 made it clear that no payment would be made by way of
25 compensation for loss of office.

Source of payment

25. Mr Panesar argued that the payment received by Mrs Panesar was not from the Post Office, but from the DTI/central government, since they had negotiated and agreed the levels of compensation, including with the EU and they had funded the
30 Post Office to make the payment. As such, the Post Office was merely the “conduit” for the payment, rather than the source of the payment.

26. In the alternative, Mr Panesar argues that if the payment is to be treated as a payment under s 401, not all of it should be so treated, at least an element (the amount over £30,000) should be treated as referable to his period of tenure and to the
35 investment which he made in the business.

HMRC’s arguments

Breadth of s 401

27. HMRC stated that it is generally accepted that sub postmasters should be treated as office holders for these purposes (by reference to the *Bimson* [TC/09/11141] decision). Only one person can hold an office at any one time. In this instance, for the purposes of s 5 ITEPA Mrs Panesar was the office holder. It was to her that all correspondence was addressed and it was to her alone that the payment was made.

28. HMRC pointed to the breadth of the wording of s 401, and suggested that it was not the case that Mrs Panesar's office termination was a "loose end". S 401 is wide ranging and can pick up payments with more than one purpose if one of them is as compensation for loss of office.

29. Mrs Panesar would not have received the compensation had she not been the sub post mistress. The fact that the payment was made on this basis overrides any wider "intention" of the payment set out in the government briefing papers to which Mr Panesar referred.

30. According to HMRC Mrs Panesar's payment was actually calculated on the basis of a "family transfer", referred to in the Post Office letter of 18 August 2008 and the DTI guidance of 6 April 2004 (even though there was no clear evidence that a family transfer had actually occurred) and on that basis she had been paid within the terms of the NRP. The fact that the compensation payment took account of Mr Panesar's period of service is "fortuitous" and does not change the character of the payment. The breadth of s 401 and its reference to payments made "by the person or the person's spouse" mean that any payment made which was referable to Mr Panesar, would be taxable on Mrs Panesar in any event.

31. The fact that Mr Panesar and Mrs Panesar's income might have been taxed as trading income was a concessionary treatment which applied only because they also ran a shop from the premises. HMRC's guidance on this concession makes it clear that it does not extend to termination payments (see EM68205)

32. There was only one contract, that was with Mrs Panesar and therefore there was also only one £30,000 threshold. Aside from Mr Panesar's oral evidence, there was no written evidence of any separate contract with Mr Panesar and no evidence of an agreement between Mr Panesar and Sir Tim Stevens.

Decision.

Is Mrs Panesar an Office Holder?

33. The first question is whether the payment made to Mrs Panesar can properly be treated as a payment to an employee or office holder. The Tribunal considers that it can. By reference to the statutory tests of what constitutes an office holder, we believe that Mrs Panesar was the office holder and agree with HMRC that only one person can be an office holder at any one time. We agree that the terms of the standard Post Office contract do not make the position clear, but nevertheless we have concluded that the essence of Mrs Panesar's role was that of an office holder in

accordance with s 5(3) ITEPA. It is clear that Mrs Panesar's role existed independently of her and had been filled by successive holders, including Mr Panesar prior to Mrs Panesar's appointment.

Scope of s 401

5 34. The onus of proof is on Mrs Panesar to demonstrate that the payment falls outside s 401. S 401 is extremely broadly drafted. To bring the payment to Mrs Panesar outside its ambit, it is necessary to demonstrate that the payment is not
10 "directly or indirectly, in consideration or in consequence of, or otherwise in connection with..." the termination of her office, or, to put it another way, that there is some independent reason for the payment having been made other than her role as office holder. This is a difficult hurdle to leap.

15 35. The courts have rarely found that payments made by an employer to an employee fall outside the scope of the basic charge to tax on employment income, (see for example the line of cases including *Shilton v Wilmshurst* ([1991] STC 88) and
20 *Hochstraaser v Mayes* ([1960] 38 TC 673)) and where they have it has been on the basis that there is a clear source of the payment which is outside the scope of the employee or officeholder's contractual obligations. In this regard, we have considered Mr Panesar's reference to national lottery winnings, but we do not think that this is a correct analogy. In the case of a lottery win, the employee wins the
25 lottery and then resigns; the resignation is the result of the lottery win. In this instance cause and effect are the other way around; the Mrs Panesar's resignation was a condition of the payment, (as set out in the Offer of Compensation letter of 20 February 2004). Second, the lottery payment is from a third party, a different source, and not, as is the case here, from the employing entity.

25 36. The drafting of s 401 is more broadly based than the general Schedule E charge considered in the above cases and as such presents an even higher hurdle for the taxpayer. This point is borne out by the decisions in *Porter v R&C Commissioners*
30 ([2005] STC (SCD) 803) and *Walker v Adams* ([2003] STC 269). HMRC's Employment Income Manual gives a number of examples of circumstances in which they consider that s 401 will bite, as well as one example of when it will not (see EIM 13020 and EIM 13910).

35 37. HMRC's example of where s 401 will not apply refers to a sale of shares owned by an employee at the time of the termination of employment. In that instance the proceeds from the share sale were not taxable under s 401 because they had a source (the ownership of the shares) which was distinct from the source of the termination payment. In Mrs Panesar's case there is no such distinct source.

The substance of the payment

40 38. The courts have stressed that in determining the nature of a payment made to an employee, the question is one of substance and not form. The substance in question is the substance of the payment in the employee's hands, rather than the form in which it is paid to him (see *HMRC v P.A Holdings Ltd* [2011] EWCA civ 1414).

39. To take Mr Panesar's point about the source of the payment being the DTI and not the Post Office we do not think that this has much force. All public sector workers are paid by the government and indeed the taxpayer at the end of the day, but that does not mean that the government entity which is their employer is not treated as the entity that pays their wages and is obliged to deduct tax from those payments. The employer is the person with whom the employee has their contract of employment. In Mrs Panesar's case this was the Post Office.

40. Case authorities in this area stress that in establishing the source of a payment, it is important to identify the "reality" of the source, see for example the judgment in *O'Leary v McKinley* ([1991] STC 42), where the fact that payment was made via a loan to trustees did not mean that it should be treated as something other than earned income. On this basis we have concluded that the "real" source of the payment made to Mrs Panesar is her employer, the Post Office.

41. Mr Panesar's arguments about the substance of the payment were not without merit. It is clearly the case that in the official documents concerning the NRP, the compensation payments were consistently described as for loss of assets and investment. We do think that the manner in which the payment was described by the DTI and the Post Office is a factor in determining its correct tax treatment. The question for the Tribunal is whether this is sufficient to over ride the specific terms of the written offer made to Mrs Panesar and the breadth of s 401. We consider that it is not, particularly by reference to *P.A Holdings* and earlier decisions quoted above which stress that the intention of the payer does not necessarily determine the tax treatment of the payment in the hands of the recipient.

42. As to the significance of the method of calculating the payment, we accept that there is some doubt as to whether the payment was made strictly within the terms of the DTI's calculations, and that this could have been as a result of the conversations which Mr Panesar had with Sir Tim Stevens. The Tribunal also accept that the manner of calculating the payment is a factor to consider in determining its correct tax treatment. However, we are not convinced that this means that the payment was made outside the terms of the NRP, and more importantly, even if it was outside the terms of the NRP, we do not think that the corollary of this is that it is also outside the scope of s 401. In this regard we agree with HMRC that the method by which the payment has been calculated is not determinative of its treatment in the office holder's hands.

43. It might be possible to argue that the payment is at least to some extent referable to the loss of investment in the business and not directly in consideration of Mrs Panesar's loss of office. It might also be possible to argue that the payment is not an immediate consequence of the termination of Mrs Panesar's office, but part of a wider agreement with the Post Office, as Mr Panesar asserts. However, it is much harder to establish, in the terms of s 401, that the payment was not "indirectly" in consideration of the loss of office and was not "otherwise in connection" with it. While the terms and details of the payment might not precisely reflect what was due to Mrs Panesar on the termination of her office, it is clear that no payment would have been due had Mrs Panesar continued in her role and the termination of her office and the cessation of the business were inextricably linked. (See for example para 2.4 of the letter to Mrs

Panesar from the Post Office setting out the compensation terms dated 20 February 2004)

Can the payment be split ?

5 44. Finally, we have considered Mr Panesar’s suggestion that, even if some of the payment is properly taxable as income in Mrs Panesar’s hands, an element of it should be attributable to him and his term of office and the investment which he made in the business. The Tribunal accepts that in principle it is possible to split a compensation payment between two distinct sources and tax it accordingly. However, on the facts of this case, unlike in the *Uppal* decision ([2010] UKFTT 10 215(TC)), there was no suggestion that this business was being run as a partnership so that some of the payment could properly be allocated to Mr Panesar. Nor is there any evidence in the documents on the basis of which the payment was made that any of it was due to Mr Panesar.

15 45. For these reasons the Tribunal has concluded that the payment made to Mrs Panesar is taxable under the provisions of s 401 and that her appeal should be dismissed.

20 46. 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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**RACHEL SHORT
TRIBUNAL JUDGE**

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RELEASE DATE: 8 November 2012