



**TC02517**

**Appeal number: TC/20120/03426**

*INCOME TAX – payments made to employee following termination of employment  
– whether made under contract of employment and thus liable to income tax – yes –  
appeal dismissed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**SIMON MANLEY**

**Appellant**

**- and -**

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

**TRIBUNAL: JUDGE DAVID DEMACK  
MRS CAROLINE ALBUQUERQUE**

**Sitting in public at London on 4 October 2012**

**The Appellant appeared in person**

**Mrs CM Douglas of HM Revenue and Customs for the Respondents**

## DECISION

1. The appellant, Mr Simon Manley, was paid certain sums of money by his employer, Xchanging HR Services Ltd (“Xchanging”) on his employment being terminated. The payments were calculated in accordance with the terms of Mr Manley’s contract of employment. He claims that he was made redundant and, as a result, the payments in question were exempt from income tax. The payments were made under the terms of a Compromise Agreement dated October 2009. In contrast, in reliance on case law, the Commissioners contend that the payments were not so exempt. We are required to decide which of those contentions is correct.
  
2. Strictly speaking, Mr Manley appeals against a closure notice of 20 September 2011 relating to the tax year ended on 5 April 2010 updating Mr Manley’s self-assessment return for the period by increasing his liability to income tax by £13,503.55. The notice was subsequently reviewed, and confirmed. In Mr Manley’s notice of appeal, he gave his reasons for appealing as “That the HMRC’s assumption that the Compromise Agreement that they constantly refer back [to] was entered into freely, is totally wrong, and does not take into account the true nature of the termination payments for the following reasons:-
  - i. The company’s original offer was for 3 months pay, after alleging poor performance by myself and my sales team. During the negotiations the company refused to accept that my notice period of 6 months was appropriate in my case, and by that act alone, were in breach of contract. This aggressive approach by Xchanging was not uncommon in the company. I was forced there by (sic) to engage a lawyer, which eventually led to the agreement in order to secure payment.
  - ii. I also contend that my dismissal and that of my staff at the same time was in effect a redundancy, as those jobs no longer exists (my letter of 14/11/11), and our roles have never been replaced.
  - iii. The eventual agreement to pay the equivalent full PILON [payment in lieu of notice] entitlement was split into two payments. The first- “3 months in lieu of notice”, and described as PILON on the November 2009 payslip (attached) for £38,522, and the remaining payment of £38,522 on 15/1/10 described on the attached payslip

as EXGRATIA. It is this latter payment that I contend should have been regarded as qualifying for the £30,000 exemption in calculating the tax for 2009/10, having regard to the circumstances stated above.

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I also believe that the tax and NI referred to in the compromise agreement had been properly applied in arriving at the termination payments I received, and would have taken into account any exemptions relating to such contested termination payments.”

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3. We accept the contents of the first two sentences of para (iii) above as fact.
4. Mr Manley appeared in person: the Commissioners were represented by Mrs C M Douglas, an Inspector of Taxes based at the Commissioners’ local compliance Appeals and Reviews office at Wrexham. Mrs Douglas provided us with a bundle of copy documents and one of the relevant legislation and case law. We did not take Mr Manley’s evidence formally since the underlying facts were agreed.
5. The facts we find are those which follow. On 14 January 2008, Mr Manley signed a contract of employment with Xchanging HR Services Ltd. His position with that company was that of head of sales – HR services. The contract provided for him to be paid an annual salary by equal monthly instalments.
6. At para 13.1 of the contract it was provided that, after a probationary period of 4 weeks, Mr Manley’s appointment was subject to a minimum period of notice by either employer or employee of 26 weeks. And at para 13.6 it was further provided that “Once notice has been given by either side the company may in its sole and absolute discretion terminate your employment with immediate effect by making you a payment in lieu of the notice period (or, if applicable, the remainder of the notice period), equivalent to the basic salary payable to you. Such payment will be subject to tax and national insurance contributions.”
7. Xchanging terminated Mr Manley’s employment with immediate effect on 9 October 2009 so that he became entitled to the payment in lieu of notice for which his contract of employment provided. The termination followed discussions between employer and employee in the process of which Mr Manley received independent advice from a solicitor. In an email to Mr Manley of 2 October 2009 the solicitor, Mr Gordon Turner, observed, “You are facing what looks like a performance type initiative possibly leading to termination. However, the issue may really be redundancy in that the projects you are working on/market conditions are more likely to be the

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‘real reason’ for any contemplated dismissal...” The solicitor’s “thoughts on a reasonable proposal” commenced as follows:

5                   “Notice – if you leave and are paid in lieu of notice, this will (may)  
                  have tax advantages although your contract may well have a PILON  
                  clause which would get in the way of that”.

8. That email was preceded by an earlier one of 25 September 2009 in which  
10           the solicitor advised, inter alia, “Under your contract you are entitled to 6  
                  months’ notice – pay in lieu is your target. There is a PILON so it can’t be  
                  paid tax free”.

9. The Compromise Agreement eventually entered in by Mr Manley confirmed  
15           that his employment with Xchanging terminated on 9 October 2009, and  
                  contained a recital to the effect that he had “received independent legal  
                  advice ... as to the terms and effect of this Agreement...” At para 2 of the  
                  Compromise Agreement it was stated that:

20                   “2. Subject to the Company’s solicitors, Barlow Lyde & Gilbert LLP,  
                  receiving a copy of this Agreement signed by the Employee [Mr Manley]  
                  and a copy of the Relevant Independent Adviser’s [Mr Manley’s  
                  solicitor’s] certificate signed by the Relevant Independent Adviser (“the  
                  Documents”), the Company shall:

25                   2.1. within 14 days of receipt of the Documents, pay to the  
                  Employee the sum of £38,522 in lieu of three months’ notice,  
                  such payment to be subject to deductions for tax and National  
                  Insurance;

30                   2.2 on or before 21<sup>st</sup> of January 2010, pay to the Employee the  
                  sum of £38,522 in lieu of the remainder of his notice period,  
                  such payment to be subject to deductions for tax and National  
                  Insurance.”

35           10. Mr Manley made his self-assessment tax return for the year to 5 April  
                  2010 on the basis that the first £30,000 of the payments in lieu of notice  
                  Xchanging made to him was free of tax as he had been made redundant.

40           11. The Commissioners opened an enquiry into the return on 19 July 2011.  
                  He was asked for an explanation as to why entries on the return differed from  
                  information reported to them by Xchanging. In response he furnished a copy  
                  of his Form P45 from Xchanging, claiming the difference between the figures  
                  on the form and his tax return was part of a “legally contested severance  
45           settlement” paid after he had left Xchanging’s employment and should have  
                  been exempt from tax.

12. The Commissioners then pointed out that the payments were in fact made in lieu of notice, and that the Compromise Agreement indicated that they would be subject to income tax and National Insurance Contributions.

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13. Mr Manley accepted an offer by the Commissioners to review their decision, and continued to claim that the payments were in fact redundancy payments, although contending Xchanging, when dismissing employees “always reverted to compromise agreements as the word ‘redundancy’ was negative”: he had not been replaced, there was no new business, senior managers had left and the head office was closed indicating redundancy. The review confirmed the Commissioners’ amendment to Mr Manley’s self-assessment return.

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14. At that point, Mr Manley appealed the closure notice containing the amendment to his return.

15. Before us, Mr Manley repeated what he had earlier claimed in correspondence with the Commissioners, saying that they had not taken into account the true nature of the payments made to him following the termination of his employment. He contended that Xchanging originally offered him 3 months’ pay on terminating his employment due to his and his sales team’s poor performance, and refused to accept that he was entitled to 6 months’ pay in lieu of notice forcing him to engage the services of a lawyer. As his dismissal and that of his team was said to have taken place at the same time, and none of them had been replaced, Mr Manley maintained that the jobs no longer existed; they were effectively made redundant. Further, although the first of the two payments made to him was referred to in his payslip as payment in lieu of notice, the second, for £38,522, referred to the second payment as having been made “ex gratia”, of which he submitted £30,000 should be exempt from tax.

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16. Mrs Douglas reminded us that Mr Manley was contractually entitled to receive the payments he did receive as payments in lieu of notice under his contract of employment, and that Xchanging had acted quite legally in dealing with the matter under the terms of para 13.6 of the contract. She added that the Compromise Agreement indicated that the contract of employment was terminated on 9 October 2009, and that the two payments that had subsequently been made to Mr Manley were liable to income tax and National Insurance Contributions. Mrs Douglas submitted that the Compromise Agreement flowed from Mr Manley’s contract of employment and under the latter he was contractually entitled to the payments; they were payments in lieu of notice, and were earnings as defined in the income tax legislation.

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17. Mrs Douglas further submitted that the payments made to Mr Manley constituted earnings as defined in s. 62 of the Income Tax (Earnings and Pensions) Act 2003 (“ITEPA”), and could not fall within s.401 of ITEPA which provided an exemption from income tax for the first £30,000 under s.403 of ITEPA.

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18. We pause there to set out ss.62, 401 and 403 of ITEPA. They read as follows;

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## **62. Earnings**

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

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(2) In those Parts “earnings” in relation to an employment, means –

(a) any salary, wages, or fee,

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(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.

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

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

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

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(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)).

## **401 Application of this Chapter**

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(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,

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(b) a change in the duties of a person’s employment, or

5 (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.

(2) Subsection (1) is subject to subsection (3) and sections 405 to [413A]  
(exceptions for certain payments and benefits)

10 (3) This Chapter does not apply to any payment or other benefit  
chargeable to income tax apart from this Chapter.

(4) For the purposes of this Chapter –  
15 (a) a payment or other benefit which is provided on behalf of, or  
to the order of, the employee or former employee is treated as  
received by the employee or former employee, and

20 (b) in relation to a payment or other benefit –  
(i) any reference to the employee or former employee is to  
the person mentioned in subsection (1), and

25 (ii) any reference to the employer or former employer is to  
be read accordingly.

**403. Charge on payment or other benefit**

30 (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 tax year if and to the extent that it exceeds the  
£30,000 threshold.

35 (2) In this section “the relevant tax year” means the tax year in which  
the payment or other benefit is received.

(3) For the purpose of this Chapter –  
40 (a) a cash benefit is treated as received –  
(i) when it is paid or a payment is made on account of it, or  
(ii) when the recipient becomes entitled to require payment  
of or on account of it, and  
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(b) a non-cash benefit is treated as received when it is used or enjoyed.

5 (4) For the purposes of this Chapter the amount of a payment or benefit in respect of an employee or former employee exceeds the £30,000 threshold if and to the extent that, when it is aggregated with other such payments or benefits to which this Chapter applies, it exceeds £30,000 according to the rules in section 404 (how the £30,000 threshold applies).

10 (5) If it is received after the death of the employee or former employee

15 (a) the amount of a payment or benefit to which this Chapter applies counts as the employment income of the personal representatives for the relevant year if or to the extent that it exceeds £303,000 according to the rules in section 404, and

20 (b) the tax is accordingly to be assessed and charged on them and is a debt due from and payable out of the estate.

(6) In this Chapter references to the taxable person are to the person in relation to whom subsection (1) or (5) provides for an amount to count as employment income.

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30 19. Mrs Douglas concluded her submissions by contending that the Commissioners' conclusion as to the nature of the payments made to Mr Manley was confirmed by Chadwick LJ in *EMI Group Electronics Ltd v Coldicott (Inspector of Taxes)* 71 TC 455 as follows:

35 "A payment in lieu of notice, made in pursuance of a contractual provision, agreed at the outset of the employment, which enables the employer to terminate the employment on making that payment... is properly to be regarded as an emolument of that employment."

40 Mrs Douglas invited us to find that Mr Manley submitted an incorrect tax return for 2009/10, and that the two payments made to him by Xchanging were chargeable to income tax under s.63 of ITEPA (and that details of his employment with that company should have been declared as income of £155,207 and tax of £41,160), so that the appeal should be dismissed.

20. The essence of the case presented to us by Mr Manley was that the Compromise Agreement superseded his contract of employment, and since the payments made to him were effectively redundancy payments, he was entitled to have paid to him a tax free sum of £30,000.

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21. We are unable to accept his submissions in that behalf. The Compromise Agreement does not supersede Mr Manley's contract of employment, but rather is to be read with it. In so reading the latter document, we are in no doubt that the payments in question must be regarded as emoluments of his employment. We agree with Chadwick LJ's remarks immediately following those relied on by Mrs Douglas as cited above that the payments to Mr Manley "fall squarely within the test posed by Lord Radcliffe in *Hochstrasser (Inspector of Taxes) v Mayes* [1960] AC 376 at 391-392, 38 TC 673 at 707 – 'paid to him in return for acting as or being an employee' – and by Lord Templeman in *Shilton v Wilmshurst (Inspector of Taxes)* [1991] STC 88 at 91, [1991] 1 AC 684 at 689 – 'an emolument "from being or becoming an employee "' – which Lord Woolf approved in *Mairs (Inspector of Taxes) v Haughey* [1993] STC 569 at 579, [1994] 1 AC 303 at 320-321:

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"The point can, I think be illuminated by considering the related question 'why is the employee entitled to six months' notice of the employer's intention to terminate his employment? The answer must be 'because that was the security, or continuity, of employment which the employee required as an inducement to enter into the contract of employment'. The answer to the question 'why is the employee entitled to a payment equal to his salary for the remainder of the six-month period if his employment is terminated by less than six months' notice?' must be the same: 'that was the security, or continuity, of salary which he required as an inducement to enter the employment'. It is necessary to keep in mind that (save, perhaps, in exceptional circumstances) the real reason why an employee requires a period of notice is not because he wants to continue working while he finds alternative employment; it is because he wants to continue being paid while he finds alternative employment."

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22. In our judgment, the determining factor in the present case is that the payments to Mr Manley by Xchanging, whatever they may be called by Mr Manley, were payments that Xchanging had contracted to make to him as part of his remuneration for his services as head of sales – HR services. The Compromise Agreement made plain that the payments made to him were subject to income tax and National Insurance Contributions, and his own solicitor advised that the payments were PILONS with similar consequences.

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23. It follows that we dismiss the appeal against the closure notice, Mr Manley having submitted an incorrect tax return for the tax year 2009/10.

24. 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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**DAVID DEMACK  
TRIBUNAL JUDGE**

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**RELEASE DATE: 01/02/2013**

Amended pursuant to rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 on 19/11/2013.

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