



TC04672

Appeal number: TC/2015/01810

*INCOME TAX – termination payment – termination of employment by
reason of redundancy-nature of payment-whether PILON-whether exempt*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

MR PETER ANDREW

Appellant

- and -

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

**TRIBUNAL: JUDGE MARILYN MCKEEVER
MRS SUSAN HEWETT OBE**

Sitting in public at the Bristol Appeals Venue on 3 September 2015

The Appellant appeared in person

**Mrs Glynis Millward instructed by the General Counsel and Solicitor to HM
Revenue and Customs, for the Respondents**

DECISION

1. *Introduction*

5 2. Mr Peter Andrew was dismissed from his employment without notice on 11 May 2011. He and his employer entered into a Compromise Agreement on 5 July 2011 under which Mr Andrew was paid the sum of £68,800. This appeal concerns the tax treatment of that sum, and in particular, whether the exemption from tax for the first £30,000 of a termination payment contained in section 403 Income Tax (Earnings and
10 Pensions) Act 2003 (“ITEPA”) applies to it.

3. *The law*

4. The relevant legislation is set out in Chapter 3 of Part 6 of ITEPA. Section 401 provides:

15 5. “(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—

6. (a) the termination of a person's employment,

7. (b) a change in the duties of a person's employment, or

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

20 9. by the person, or the person's spouse or civil partner, blood relative, dependant or personal representatives.

10. (2) Subsection (1) is subject to subsection (3) ...

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

25 12. Section 403 sets out the consequences of the Chapter applying.

13. “(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.

30 14. (2) In this section “the relevant tax year” means the tax year in which the payment or other benefit is received.

15. (3)...

16. (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...”

17. The effect of section 403 is that a termination payment within section 401 is not chargeable to tax to the extent that it does not exceed £30,000. Where the total
5 payment is more than this amount, the first £30,000 is tax free.

18. Section 401(3) is important in the present case. It provides that the exemption only applies to payments which are not chargeable to income tax under any other legislation.

19. So payments which constitute “earnings” within section 62 ITEPA will be
10 chargeable to tax under that section and the £30,000 deduction provided by section 403 will not be available.

20. Section 62 provides as follows:

“(1) This section explains what is meant by “earnings” ...

(2) ... “earnings”, in relation to an employment, means—

15 (a) any salary, wages or fee,

(b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or

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

21. An “emolument of the employment” is a wide term and essentially covers any
20 payment which results from the employment relationship ie which derives from the employment contract. It does not apply to a payment made in compensation for a breach of that contract.

22. *The facts and evidence*

23. *Background and history*

24. Mr Andrew is 49 years old. For many years, he has been an executive in the
25 food and drink industry. Between 2009 and 2011 he worked for Wensleydale Dairy Products Limited (“Wensleydale”), the producer of Wensleydale cheese. From 1 April 2009 to 30 March 2011, Mr Andrew worked for the company under a consultancy agreement. On 1 April 2011 Mr Andrew entered into an employment contract with
30 Wensleydale under which he was employed as the Commercial Director. He was responsible for sales and marketing and was a main board director.

25. On 11 May 2011 he was called in to a meeting with the managing director and told he was to be made redundant with immediate effect. He was not given any notice. He was not offered any reason for his dismissal either then or later. Despite several

requests, Mr Andrew was unable to obtain a copy of the notes of the meeting. There may not have been any notes.

26. Wensleydale gave Mr Andrew a Compromise Agreement on 25 June and he was advised to seek the advice of an employment lawyer, which he did. Mr Andrew told us that his lawyers, Humphreys & Co confirmed that his employment had ceased because of redundancy and that he was entitled to the deduction under section 403 ITEPA for the first £30,000 of that payment. We did not see a copy of that advice, but we did see a letter dated 11 July 2011 sent to Wensleydale’s solicitors, Jacksons, by Humphreys & Co referring to the deduction. Wensleydale were seeking to deduct PAYE from the whole of the termination payment and the letter states “It is agreed between us that there is no PILON [pay in lieu of notice] clause in our client’s contract of employment and we cannot therefore see any basis for the first £30,000 being taxed...”.

27. Mr Andrew told us he was unable financially to continue his claim against Wensleydale and felt under pressure to sign the Compromise Agreement. He did sign it on the basis that the company deducted tax from the whole payment, but recorded a dispute and Mr Andrew would then seek to recover the tax over-deducted from HMRC.

28. Mr Andrew’s accountants duly submitted his tax return for the year 2011-12. In it, he declared the receipt of the payment on termination of his employment with Wensleydale and claimed the exemption for the first £30,000 of that payment. On the basis of the figures in the tax return, Mr Andrew was due a repayment of £6,904.00 overpaid tax.

29. HMRC operates a “process now, check later” system and some time after the return was filed, HMRC’s computer system noted the payment of the lump sum and triggered a check of the tax return. By a letter dated 26 November 2013, HMRC commenced an enquiry into the ”employment/redundancy payment” under section 9A Taxes Management Act 1970.

30. Mr French of HMRC sent a closure notice under section 28A Taxes Management Act 1970 to Mr Andrew on 3 September 2014, having concluded the check of the tax return. There was no dispute about the figures. The final payslip showed total payments of £103,121.16. This was made up of:

Back pay	£ 33,050.01
Pay in lieu of notice, car allowance, pension contributions	£ 68,000.00
35 Holiday pay (holiday accrued but not taken)	<u>£ 1,271.15</u>
Total	£ 103,121.15

31. Mr French did not consider that the £30,000 exemption was available as discussed below and amended Mr Andrew’s self-assessment tax return accordingly. This turned a tax overpayment of nearly £7,000 into a tax underpayment of £8,096.61.

32. Mr French accepted that, on the basis of the documents and the advice Mr Andrew had received, it was understandable that he thought he was entitled to the exemption and as he had taken reasonable care in completing his tax return, HMRC did not seek to charge a penalty.

5 33. Mr Andrew requested a Statutory Review of the decision and this was completed on 13 January 2015, confirming the amendment to the 2011-12 tax return. Mr Andrew now appeals against that amendment to the tribunal.

34. *Why was Mr Andrew's employment terminated?*

10 35. Mr Andrew told the tribunal that, at the May 2011 meeting with the managing director he was told he was being made redundant. The Compromise Agreement provided in its recitals that "the Employee's employment with the Company will be terminated with effect from 25th June 2011...by reason of redundancy".

15 36. As part of the enquiry process, HMRC can, and in this case, did raise queries with the employer. A note of phone call dated 25 March 2014 records "Wensleydale Dairy Products Ltd phoned with regards to [HMRC's] letter dated 26/2/14, she advised that t/p [taxpayer] was not made redundant but the payment received was under a compromise agreement therefore no £30,000 limit included in payment".

20 37. Both in correspondence with HRMC and at the hearing, Mr Andrew continued to assert that he had been made redundant and in a letter to Mr French received on 23 June 2014 he referred to letters from his lawyers stating that they believed he was made redundant. He had taken legal action against Wensleydale to clarify the position, but could not pursue it for financial reasons. At the hearing, he informed us that he had not been replaced by the company and that the company no longer had the position which he had previously fulfilled. Although he had tried to obtain a copy of a recent company structure chart he had been unable to do so.

38. Mr Andrew struck us as an honest and straightforward witness and we accept his evidence. On the basis of that and the documents, we find that he was made redundant. HMRC also accepted this in a letter accompanying the closure notice, dated 3 September 2014.

30 39. *What were the payments for?*

40. As noted, Mr French accepted that Mr Andrew had been made redundant, but as he went on to say in the 3 September letter :

35 41. "However, this does not mean that the payments you received automatically fall within the legislation at S401 ITEPA 2003 and so attract the £30,000 exemption. The critical question is "what were the payments for?". For the answer to this question we look to the information provided by the employer, the final payslip and the compromise agreement."

42. The breakdown of the figure in the final payslip is set out at paragraph 30. At the hearing, Mr Andrew provided a further breakdown of the £68,800 figure. This

comprised, first, six months' basic salary-£54,000 on the basis of an annual basic salary of £108,000. The second component was a car allowance for six months at £800 a month-a total of £4,800. The third element was a payment in respect of six months' pension contributions at the rate of 20% of salary, totalling £10,800.

5 43. *Mr Andrew's contract of employment*

44. In order to establish the legal nature of the payments, the tribunal examined Mr Andrew's contract of employment. The relevant provisions are set out below.

45. Clause 1 of the contract provided "The Company shall employ the Director [Mr Andrew]...from 1st April 2011...and thereafter unless and until determined by not less than six months' notice in writing...given by either party to the other....1.2 Payment in lieu of notice may be given by the Company except in the case of [summary dismissal] when notice does not apply".

46. So Mr Andrew's basic entitlement was to six months' notice, but the Company had the option, at its discretion, under the terms of the contract, to make a payment to Mr Andrew instead of giving him notice.

47. Mr Andrew was entitled to an initial salary of £108,000 per annum.

48. Wensleydale undertook in clause 5.1 to pay all reasonable expenses "wholly necessarily and exclusively incurred by [Mr Andrew] in the performance of his duties under this Agreement".

49. Clause 6 provides that "the Company shall, during the continuance of his employment hereunder, provide the Director with a suitable motor car for his sole business use and private use by himself (and spouse). The Company shall meet all expenses of the said motor car..."

50. The Director had the option, under clause 6, to elect to receive additional remuneration instead of a car. "The current level of this benefit is £8,000 per annum..."

51. Clause 17 of the contract provides that "the Director is entitled to participate in the Company's Pension Scheme." The contract does not specify the level of contributions but Mr Andrew told us that the company contributed at the rate of 20% of salary.

52. Clause 14.4 deals with various miscellaneous provisions relating to the termination of the employment. The proviso to clause 14.4 states "provided that during the notice period the Director's salary and other contractual financial benefits are continued to be paid (sic) by or on behalf of the Company."

35 53. *The Compromise Agreement*

54. The Compromise Agreement dated 5 July 2011 set out the terms on which Mr Andrew's employment was terminated. As mentioned above, the employment was terminated without notice with effect from 25 June 2011 and the Agreement recited that the employment was terminated by reason of redundancy.

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55. Clause 4 of the Agreement stated that "the Employee has intimated that but for this agreement he would have claims against the Company for unfair dismissal and/or breach of contract and/or wrongful dismissal and/or unlawful deduction from wages and/or a redundancy payment." It recorded that the effect of the agreement was that the Employee would not be able to pursue any such claims.

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56. Clause 2 provided "The Employee accepts that this agreement is in full and final settlement of all and any claims the Employee may have arising out of the Employee's contract of employment or its termination. This agreement is in settlement of any claim for:-

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2.1 unfair dismissal...;

2.2 breach of contract or wrongful dismissal (including without limitation any claim for payment in lieu of notice, payment for any benefits or bonuses...pension contributions, holiday pay, salary, the provision of any benefits in kind..);

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2.3 unlawful deductions from wages;

2.4 a redundancy payment."

57. Clause 7 set out the payments to be made which were as follows:

58. "7.1 £68,800 (less PAYE deductions and less £650 which the parties have agreed in return for the retention by the Employee of his laptop pc) as payment of salary in lieu of the Employee's notice period which it has been agreed the Employee will not be required to work. For the avoidance of any doubt this sum comprises basic salary, car allowance and Company pension contributions."

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59. Clause 7 also made provision for a payment in respect of accrued but untaken holiday which it was agreed was taxable and a payment in respect of expense claims which it was agreed was not taxable.

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60. The £68,000 payment was described in clause 7.1 as a payment of "salary" which was not quite accurate. It was, in fact, a payment of the salary plus the benefits which would have been paid during the notice period to which Mr Andrew was entitled and was being paid instead of giving that notice period.

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61. *Mr Andrew's contentions*

62. Mr Andrew contends that his employment contract was terminated by reason of redundancy-which HMRC ultimately accepted, despite the confusion occasioned by the telephone call with Wensleydale.

5 63. Mr Andrew further contends that the payment made pursuant to the Compromise Agreement was a redundancy payment, the first £30,000 of which is exempt by virtue of section 403 ITEPA.

64. *HMRC's contentions*

10 65. HMRC contend that even if Mr Andrew was made redundant, that does not automatically mean that a termination payment falls within section 401 ITEPA. The £30,000 exemption only applies where the payment is made under the statutory redundancy provisions or under a non-statutory redundancy scheme.

66. HMRC argue that where a payment is made in lieu of notice (a "PILON") under the terms of the contract itself that payment flows from the employment relationship and accordingly is taxable as "earnings" under section 62 ITEPA.

15 67. This means that the payment is chargeable to income tax apart from the provisions of Chapter 6 of Part 6 ITEPA and so it cannot fall within section 401 and cannot be exempt to the extent of the first £30,000 under section 403.

68. Although Mr Andrew's primary entitlement under the contract was to six months' notice, the company reserved the right to make a payment in lieu of notice.

20 69. Accordingly, HMRC argue that the payment under the Compromise Agreement was a contractual PILON taxable under section 62 ITEPA and not a payment of damages for breach of contract, which would have fallen within section 401.

25 70. As it fell within section 62, the whole payment was taxable, PAYE was correctly operated and Mr Andrew should not have claimed the £30,000 deduction in his tax return.

71. *Discussion*

72. The important question in this case is not whether Mr Andrew was made redundant (though we have found that he was) but the nature of the payment made to him under the Compromise Agreement.

30 73. The case of *EMI Group Electronics Ltd. v Coldicott* 71 TC 455 affirmed by the Court of Appeal ([1999] All E R 803) involved a situation similar to the present case where "the company would give the employee six months' notice of its intention to terminate the employment but the company reserved the right to make payment of the equivalent of salary in lieu of notice".

35 74. Neuberger J, in the High Court, held that a PILON was an emolument "from" the employment. He said:

75. “the receipt of a PILON appears to me to arise from the existence of the employer-employee relationship.... To put the point in a slightly different way, the right to a PILON was “directly connected with the employment”.... The terms on which an employment contract can be brought to an end seem to me to be self-evidently an inherent part of the contractual relationship...”

76. In upholding Neuberger J’s decision, Chadwick LJ in the Court of Appeal said “The question, therefore, is whether 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 from that employment. ... I would have no doubt that that question must be answered in the affirmative.” The payment was, accordingly, taxable.

77. The judge found that the PILON was taxable as earnings even though, as in this case, the PILON was payable at the discretion of the company.

78. In the *EMI* case, the employment contract provided for a payment of “salary” in lieu of notice. Mr Andrew’s contract provides simply for the company to have discretion to make a “payment” in lieu of notice. Clause 7.1 of the Compromise Agreement could have been more felicitously worded, but it seems clear that the total of the basic salary and the amounts in relation to the other benefits were intended to constitute the “payment” which the company was entitled to make in lieu of notice under clause 1.2 of the contract of employment.

79. We considered whether it mattered that the payment in respect of the pension contributions would have been tax free if it had, in fact, been paid to the pension scheme. The fact is it was not paid to the pension scheme; Mr Andrew received a sum of cash equal to the payments which would have been made had he worked during the notice period. The cash sum in respect of pension contributions was accordingly to be treated in the same way as the rest of the payment.

80. *Conclusion*

81. For the reasons set out above, we find that although Mr Andrew was made redundant from his position with Wensleydale, the payment he received under the Compromise Agreement was a payment made by the company in lieu of notice in accordance with the right given to them to do so by the employment contract itself.

82. The payment was accordingly a contractual PILON and is taxable under section 62 ITEPA as earnings. The payment does not therefore fall within section 401 ITEPA and it cannot benefit from the exemption in section 403 ITEPA.

83. We dismiss the appeal.

84. 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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**TRIBUNAL JUDGE
MARILYN MCKEEVER**

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RELEASE DATE: 6 OCTOBER 2015