[2017] UKFTT 0275 (TC)

TC05754

Appeal number:TC/2015/7324

Income Tax – termination payment - whether assessment out of time – section 36(1A) TMA – whether taxpayer should have notified HMRC under section 7 TMA – whether termination payment had been accounted for under PAYE regulations – time of payment – section 686 ITEPA. Application of regulation 185 PAYE Regulations

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR D A GRAY **Appellant**

- and -

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

TRIBUNAL: JUDGE CHARLES HELLIER
KAMAL HOSSAIN

Sitting in public at Fox Court, London on 2 March 2017

David Boyd of Silver Levene for the Appellant

Steve Goulding for the Respondents

DECISION

Background

1. The following facts were uncontroversial

2. In March 2008 Mr Gray's employment contract with ITV Services Ltd ("ITV") was terminated. Pursuant to an agreement with ITV dated 20 March 2008 he was paid a large sum in settlement of the claims he had or might have had against ITV, and it was agreed that the last date of his employment (the "Termination Date") would be 31 March 2008. ITV paid the termination sum on 9 April 2008 after deducting basic rate tax from that part of it which exceeded £30,000.

3. HMRC did not send Mr gray a tax return for 2008/8 or 2008/9, and Mr Gray did not notify HMRC of his receipt of, or his entitlement to, the termination sum.

4. In December 2013 HMRC issued a discovery assessment for 2008/9 (the year the termination sum had been paid). The calculation of the tax due on this assessment was made on the basis that: (1) the termination sum (apart from the first £30,000) was taxable employment income of 2008/9, (2) that the only tax which had been deducted by ITV on the making of the payment of that sum was basic rate tax, and (3) that only the tax actually deducted by ITV should be set against the tax due on his income[1].

5. After the receipt of that assessment at the end of 2013 Mr Gray appointed Silver Levene to act for him. In the first half of 2014 there was correspondence between Silver Levene and HMRC, and in June 2014 Silver Levine wrote contending that the termination sum was properly assessable in 2007/8 and not in 2008/9. There was further correspondence and in June 2015 HMRC indicated that they would discharge the 2008/9 assessment and issue a new one for 2007/8 calculated in the same way. On 28 August 2015 HMRC sent Mr Gray an assessment for 2007/8 (the year of leaving).

The Issue in this Appeal

6. Mr Gray contends that the 2007/8 assessment was made outside the time limits permitted by the Taxes Management Act 1970 ("TMA"). That is the issue in this appeal.

7. HMRC had also assessed penalties under Section 7 TMA on Mr Gray on the basis that he had negligently failed to notify them of the source of income giving rise to the Termination Sum (section 7 requires a taxpayer who has not been sent a tax return for a year to notify HMRC of certain sources of income he has for that year). Mr Gray appealed against those penalties and we were told by Mr Golding

[1] Together with tax deducted on interest receipts irrelevant to this appeal

that they had been withdrawn. Thus the only issue before us was whether or not the 2007/8 assessment was made within the time limits prescribed by TMA.

Further Findings of Fact.

8. Mr Gray told us, and we accept, that the period leading up to his leaving ITV in March 2008 had been very stressful. He had held a senior position and there was some gossip about his leaving he had to ignore. He had instructed lawyers to negotiate a settlement with ITV. He had discussed the central issues with the lawyers - the amount of the payment, questions of confidentiality, his claims of unfair dismissal, and reference letters - but had not discussed the details of the agreement or received advice in relation to tax. Once the lawyers had said they were content with the form of the agreement he had signed it and put it away without reading it. It was not something he wanted to think about at that time..

9. Mr Gray also told us, and we accept, that he had no other sources of income in 2007/8 or 2008/9 (other than the interest received in 2008/9).

The Parties' Arguments.

10. We have found the statutory provisions in this appeal quite complicated. We intend no discourtesy to Mr Golding or Mr Boyd by summarising only very briefly the thrust of their arguments before dealing with the effects of the legislative provisions.

11. The essence of HMRC's case was that Mr Gray should have given HMRC notice of the receipt of his termination payment, that in failing to do so he was careless or negligent, and that those features opened the door to an assessment outside the normal time limits.

12. Mr Boyd, on the other hand, says that Mr Gray received his payment after tax had been deducted and it was not careless or negligent to rely upon tax having been properly deducted.

Particular terms of Termination Agreement.

13. Clause 2.3 of the Agreement provides that:

> "Subject to the Employee's compliance with all obligations imposed by virtue of this agreement and in full and final settlement of claims set out in clause 9.1 and 9.2 below, the Company shall without admission of liability provide the following as compensation for loss of employment:
>
> > 2.3.1 the Company will pay to the employee a termination payment in the sum of £221,136 ("Termination Payment").
> >
> > 2.3.3 [there was no 2.3.2: it may have been deleted] The first £30,000 of the Termination Payment shall be made without deduction of income tax or national insurance contributions pursuant to section 406 [ITEPA] and the remainder shall be subject to the appropriate deductions for income

tax at the basic rate and where applicable national insurance contributions. The Employee shall be fully liable to account to the Inland Revenue for the Additional Tax due on the Termination Payment and fully indemnifies the Company in this respect."

14. “Additional Tax” was defined as such "further income tax, employee’s national insurance contributions, interest and/or penalties thereon arising in respect of the payments made and benefits provided under this agreement other than income tax deducted by the company at clause 2.2 [which related to outstanding pay and expenses]”.

15. Clause 5 contained an indemnity from Mr Gray to the company if it were liable to account to HMRC for any Additional Tax other than tax liable by reason of default of the company.

16. We note that clause 2.2 of the agreement set no time in relation to which the Termination Payment had to be made. In contrast clauses 2.6, 2.8 and 3 provided that the relevant payment should be made within 14 days of a particular event.

17. We also note that ITV's obligation to make payment under clause 2.3 was made "subject to the employee’s compliance with all obligations imposed by" the agreement. Those obligations included some (such as those in relation to garden leave - which proscribed contact with ITV's clients and customers during a period of garden leave) compliance with which was required only up to the Termination Date, and others (such as that of confidentiality) which extended beyond that date.

18. In the absence of an express provision for the date of payment it seems to us that it should be implied into the agreement that the payment be made within a reasonable time after the Termination Date - giving time for ITV to check that the conditions of the agreement had been fulfilled and to authorise and arrange payment. In our view, given a Termination Date of 31 March, payment would not reasonably be due and payable until a few days after 5 April.

Discussion and Legislation

19. Section 29 TMA provides that an assessment may be made where an officer of HMRC “discovers” that income which ought to have been assessed has not been assessed. There was no dispute that the requirements of section 29 had been met in relation to the 2007/8 assessment.

20. Section 34 TMA provides for an "ordinary" time-limit subject to extensions provided in later sections. In the form of that section which applied at the relevant times this section proscribed the making of an assessment more than five years after the 31 January next following after the year of assessment concerned. For 2007/8 the relevant 31 January was 31 January 2009, so that an assessment for that year made after 31 January 2014 would be outside the permitted limit. Thus if no extending section applied the 2007/8 assessment, made in August 2015, would have been unlawful.

21. Section 36 provides for an extended time limit. This section was amended by the Finance act 2008. In its form prior to amendment it provided that an assessment could be made up to 20 years after the 31 January after the end of the year of assessment if the loss of tax had been brought about by the "fraudulent or negligent conduct" of the taxpayer.

22. Thus if section 36 applied in this form and Mr Gray had been negligent, the 2007/8 assessment would have been lawful.

23. In its form as amended by paragraph 9 schedule 36 for FA 2008, section 36 provided in subsection (1) that an assessment could be made at any time within six years after the end of the year of assessment if a loss of tax been brought about carelessly by the taxpayer; and

> "(1A) An assessment on a person in a case involving a loss of income tax or capital gains tax: -
>
> (a) brought about deliberately by the person,
>
> (b) attributable to a failure by the person to comply with an obligation under section 7 [the requirement to notify HMRC of certain sources of income], or
>
> (c) [irrelevant in this case]
>
> may be made at any time not more than 20 years after the end of the year of assessment ...".

24. Under new section 36(1) of these provisions if Mr Gray had been merely careless the assessment for 2007/8 could be made only before 31 January 2015. In that case the 2007/8 assessment made in August 2015 would have been out of time under the extension provided by subsection (1).

25. However if the extension in subsection (1A) applied the time limit was 20 years. On that basis the 2007/8 assessment would have been in time.

26. Section 118 (2) FA 2008 provided that the substitution made by paragraph 9 schedule 36 came into force on such day as the Treasury might by statutory instrument appoint. That appointment was made in the Finance Act 2008 Schedule 39 (Appointed Day Transitional Provisions and Savings Order) 2009 SI 2009/403. Paragraph 2 of that Order specified 1 April 2010 as the appointed day but paragraph 7 provided that new subsections 36(1A) (b) and (c) should not apply where the year of assessment was 2008/9 or earlier, except where the assessment was for the purposes of making good tax lost as a result of the taxpayer's negligent conduct.

27. We consider that the effect of the Order was, not that for 2008/9 and earlier years the old rule should apply, but that for those years the new rules should apply to assessments made after 1 April 2010 but with the excision of (1A) (b) and (c) except in cases of negligence.

28. Thus for an assessment made after 1 April 2010 (such as the assessment in this appeal) the 20 year extension for negligence in the old section 36(1) did not apply and in relation to the 2007/8 assessment (or one for 2008/9), the provisions of the Order and s36(1A) apply so that the 2007/8 assessment would be lawful only if:

> (1) the taxpayer had been negligent (because of the terms of the Order); and
>
> (2) the loss was brought about deliberately, or was attributable to a failure to comply with section 7.

29. HMRC did not allege that Mr Gray brought about the failure to collect tax deliberately. They assert that he was negligent and that he failed to comply with section 7. Accordingly they say that the assessment was in time under the effect of the transitional provisions.

Negligence or carelessness

30. HMRC argue that given in particular the provisions of clause 2.3 and 5 of the Termination Agreement, which placed the onus on Mr Gray to account for Additional Tax and to indemnify ITV if too little tax had been deducted, he was careless or negligent in that he had not considered whether additional tax was due and whether he ought to report his income to HMRC

31. We have been able to determine this appeal without needing to come to a conclusion on this issue. We found it a difficult issue given that this was employment income even though of a large amount.

The Requirements of Section 7 TMA.

32. Section 7 (1) TMA provides that every person who is chargeable with income tax and has not been sent a tax return must notify HMRC of his chargeability within six months of the end of the year unless subsection (3) applies. In the context of this appeal, subsection (3) applies where all the person's income comes from sources within subsections (4) to (7). Only sections (4) and (5) are potentially relevant in this appeal. They provide:

> "(4) A source of income falls within this subsection in relation to a year of assessment if -
>
> > (a) all payments of, or on account, income from it during that year, and
> >
> > (b) all income from it for that year which does not consist of payments,
>
> have or has been taken into account in the making of deductions or repayments tax under PAYE regulations.
>
> (5) A source of income falls within this subsection in relation to any person and any year of assessment if all income from it for that year has been or will be taken into account -

(a) in determining that persons liability to tax or

(b) in the making of deductions or repayments tax under PAYE regulations."

33. The effect of these exceptions is that if all Mr Gray's income (including the payment of the termination sum) was taken into account for PAYE, Mr Gray had no duty to notify HMRC under section 7 and the 2007/8 assessment would be out of time since the extension in 36(1A) would not apply.

34. Mr Goulding argued that, because ITV had deducted tax at the basic rate only, Mr Gray's income from the termination payment could not be said to have been taken in to account under the PAYE regulations. We need to turn to the PAYE Regulations to address this argument, but first we should deal with two issues in relation to the construction of section 7(4) and (5) which were not explored in detail before us.

35. *First,* it was common ground that, as a result of section 403 Income Tax (Earning and Pensions) Act 2008 ("ITEPA"), the first £30,000 of Mr Gray's termination payment did not count as taxable "employment income". There was therefore an argument that even if PAYE was correctly applied to the termination sum it was not applied to "all income" from his employment since it was not applied to the first £30,000, and that accordingly Mr Gray had an obligation to notify under section 7 which was not saved by subsections (4) or (5).

36. We reject that argument for two reasons. First section 7 is concerned with the sources of income which are within the charge to income tax in a particular year and the exclusion of the first £30,000 of the termination payment (which normal parlance might not even be regarded as "income") means that it is not income with which the section is concerned. Second, even if it is such income, if it has been accounted in determining the tax which is deductible, it is in our view a proper use of language to regard it as taken into account in the making of deductions under the PAYE Regulations.

37. In this context we note that subsection (5) refers to the possibility that amounts "will" be taken into account under PAYE. Thus the obligation to notify is not dependent upon PAYE actually having been accounted for. That indicates that it is the fact that PAYE regulations will apply to a sum rather than the fact that the employer has actually deducted which should exempt the taxpayer from a duty to report.

38. *Second,* the exemptions for the duty to notify in section 7 deal with "sources" of income in a particular year. In *Bray v Best* [1989] STC 159 it was held that a payment made in relation to a termination of employment in a year after the employment had ceased did not, on the facts, have an employment *in that year* as its source. It might therefore be argued that, whilst the termination payment was by virtue of Part 6 ITEPA taxable employment income it had no source in the relevant year and thus was income which fell outside subsections (4) and (5).

39. We would reject that argument too. The provisions of ITEPA make a payment in consequence of termination of employment taxable income "for" the year in which the payment is received (see s 404). The source arises in the year in which the payment is treated as being "for": it was thus capable of falling within (4) or (5) for the year in which it was received. Further it would not be "income" in relation to a year in which it was not received. .

The PAYE Regulations

40. Mr Goulding told us that HMRC considered ITV had applied to PAYE regulations correctly the termination payment. It had treated the termination payment as subject to PAYE in 2008/9 and in accordance with the then published practice of HMRC. PAYE at the basic rate had been deducted.

41. Regulation 37 of the PAYE Regulations provides that if a "relevant payment" (which by Regulations 2, 4, and 3, and section 683(1) & (2) and Part 6 ITEPA includes a termination payment) is made to an employee after the employment has ceased and the payment has not been included in a form P45, then the person making payment must deduct tax the basic rate in force to the relevant year. As a result if for the purpose of the Regulations the termination payment is to be treated as made in 2008/9, it was correct that ITV should deduct PAYE at the basic rate.

42. By contrast if the payment is to be treated as made in 2007/8, the effect of Regs 21ff is that tax should have been deducted by reference to Mr Gray's tax code on a cumulative basis.

43. Thus the next question is when the payment is to be treated as made for the purposes of the Regulations.

44. Section 686 ITPA provides that for the purposes of the regulations a payment of such income is to be treated as made on the earliest of:

> "*Rule 1* the time when the payment is made,
>
> *Rule 2* the time when the person becomes entitled to payment
>
> [other presently irrelevant times]."

45. In *UBS AG and DB Group Services (UK) Limited v HMRC* [2012]UKUT 320 (TCC) the Upper Tribunal considered the meaning of "becomes entitled to payment" in section [18] ITEPA - whose words match those of section 686. It said:

> "[61] At the heart of this part of the case is a question of construction which, although nowhere articulated in the decision of the FTT, was the subject of considerable debate before us. That question is whether the words "entitled to payment" in Rule 2 of section 18(1) denote only a present right to present payment, or whether they are wide enough to include a right to payment in the future (which may or may not be subject to defeasance or contingencies). UBS argues for the former interpretation,

while HMRC argue for the latter. Surprising though it may seem, there appears to be no direct authority on the point."

After considering the arguments the tribunal continued:

"[70].. Furthermore, the argument now advanced by HMRC appears to be at odds with the guidance given in paragraph 42290 of the Employment Income Manual, which states that Rule 2 is concerned with the date when a person becomes entitled to payment of earnings, which "is not necessarily the same as the date on which an employee acquires a right to be paid". The example is then given of an employee whose terms of service provide for him to receive a bonus for the year to 31 December 2004, payable on 30 June 2005 if he is still in the employer's service at the end of2004. If the condition is satisfied, the employee becomes entitled to a payment on 31 December 2004, but is only entitled to payment of it on 30 June 2005: "So PAYE applies to it on 30 June 2005 and it is assessable for 2005/06. The date that matters is the date the employee is entitled to be paid the bonus". In our view that passage accurately reflects the law, and UBS is right to submit that Rule 2 is concerned with a present entitlement to present payment."

46. That conclusion was not disturbed in the subsequent appeals.

47. We have held that the effect of the Termination Agreement was that Mr Gray's right enforce payment arose a few days after 5 April 2008. Only then did he have a present right to present payment. The payment itself was also made after that date. As a result we conclude that for the purposes of section 686 the Termination Payment was paid in 2008/9 and not in 2007/8. That means that ITV correctly accounted for PAYE in accordance with the PAYE Regulations.

48. That in turn means that all income from the termination of Mr Gray's employment was taken into account under those regulations and accordingly that Mr Gray was not required to notify under section 7 (in respect of either 2007/8 or 2008/9) since the income form the termination was or would be so taken into account.. And that means that the extended limit in section 36(1A) does not apply and that the 2007/8 assessment was out of time.

Other and Further Considerations

49. The rule in section 686 has a parallel in section 403. That latter section is in the part of ITEPA which deals with termination payments. The section provides a rule for determining in relation to which year a termination payment or benefit falls for the purposes of assessment tax (rather than deduction under PAYE[2]). Section 403

1. [2] Employment income arising by virtue of the termination payment is not general earnings for the purposes of ITPA. General earnings are, by section 18 ITEPA, treated as received in accordance with the same formula as applies for PAYE (see section 18 ITPA). The slightly different formulation in section 403

(1) provides that the amount of the payment counts as employment income "for the relevant year" to the extent it exceeds £30,000. Section 403 (2) provides that the "relevant year" is the year in which "the payment ... is received", and section 403 (3) provides:

> "(3) For the purposes of this Chapter -
>
> (a) a cash benefit is treated as received -
>
> (a) when it is paid ... or
>
> (b) when the recipient becomes entitled to require payment of or on account of it.".

50. The parallel between the PAYE provisions of section 686 and the timing provisions of section 403 is not exact. There are two particular differences: (i) the result of the “or” in (3)(a)(i) is that section 403 does not specify that it is the earlier of payment or entitlement, whereas section 686 does; and (ii) section 403 speaks of entitlement "to require payment of it" where a section 636 simply as speaks of becoming "entitled to the payment".

51. Mr Goulding said that HMRC accepted that the “or” in section 403 left the choice of the year of assessment to the taxpayer, and in this case the taxpayer had chosen 2007/8. We are less certain, but on our interpretation of the Termination Agreement we find that Mr Gray became “entitled to require payment of or on account of" the termination payment in 2008/9, and as a result, because it was also actually paid in that year, that it was assessable only in 2008/9.

52. What would be the case in relation to an assessment for 2008/9 made on the basis that the sum was assessable and arose in that year? In this case, since payment was made in 2008/9, not only would the taxable termination payment be assessable only in 2008/9 but the PAYE regulations would require the payment to be accounted for only in 2008/9. Such PAYE would have been correctly deducted at the basic rate only and the balance would remain assessable if the assessment was in time. The actual assessment for 2008/9 was withdrawn, but for completeness we set out our conclusions in relation to whether or not an extended time limit applied to it.

53. The extended time limit would apply only if: (i) Mr Gray was negligent, and (ii) the conditions of section 7 were not satisfied.

54. We find that the conditions of section 7 would be satisfied. That is because, on this hypothesis all the income from ITV would have been taken into account in making deductions under the PAYE regulations and Mr Gray had no other relevant source of income.

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controls the year in which a termination payment is to be treated as taxable (see section 9 (4), 10 (3), and 403 (1): "income for that year".).

55. If our interpretation of the agreement is wrong and the entitlement to payment arose in 2007/8, the following consequences would follow (on the basis that the effect of section 403 was that the payment was assessable in 2007/8). First, the payment would be treated for PAYE Regulation purposes as made in 2007/8 because of section 686 ITEPA.

56. Second, since the right arose in 2007/8 PAYE should have been accounted for in 2007/8 on the basis of Mr Gray's tax code at the relevant higher rates. It was not. This might mean that "all" Mr Gray's income was not income from sources taken into account in the making of deductions under the PAYE Regulations. If that were the case then the exceptions in section 7 would not be not satisfied and the 2007/8 assessment would be in time if Mr Gray had been negligent.

57. . But in this case regulation 185 of the PAYE regulations would apply to determine the tax to be treated as deducted in making the assessment. By regulation 185(5) and (6) the tax to be treated as deducted from the payment includes the tax ITV was liable to deduct but failed to deduct (no direction having been made under regulation 72). That it seems to us would be equal to the tax assessed by the actual assessment (because Mr Gray had no other income in that year and his tax code represented the benefit of his personal allowance). Accordingly the net assessable amount would be nil.

58. In a similar vein, if Mr Gray's right to present payment arose before 6 April 2008 but section 403 required assessment to be made in the year of actual payment, then, even if the condition in section 7 were satisfied so that the 2007/8 assessment could be made, no tax would the assessable since the payment would not be employment income of 2007/8.

Conclusions

59. In our view the correct analysis is that the income was assessable in 2008/9 and ITV correctly accounted for PAYE in that year. Thus not only was there no additional tax to assess in 2007/8 but the assessment for that year would have been out of time because Mr Gray was not required to notify any other source of income under section 7 for that year.

60. If we are wrong and the right to present payment arose in 2007/8 and the income was assessable in 2007/8 then, even if the assessment was in time, it must be reduced to nil.

61. We allow the appeal.

Rights of Appeal

62. 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.

CHARLES HELLIER
TRIBUNAL JUDGE

RELEASE DATE: 6 APRIL 2017