TC07936

INCOME TAX – police officers – dispute with Metropolitan Police concerning over-time payments – settlement agreement – sums paid in respect of legal fees and insurance – whether employment income

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2018/02400

BETWEEN

KEITH MURPHY **Appellant**

-and-

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

TRIBUNAL: JUDGE GUY BRANNAN

Sitting in public at Taylor House, London on 5 February 2020

Michael Collins, counsel, instructed by Fraser White, Accountants, for the Appellant

Joshua Carey, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. This is an appeal by Mr Keith Murphy against a decision of the Respondents dated 12 March 2018 which closed an enquiry into his tax affairs and against a number of discovery assessments for the tax years ending 2009 to 2016 (all of which were also issued on 12 March 2018).

2. Mr Murphy was a police officer with the Metropolitan Police Service ("**the MET**"). Mr Murphy together with a number of other officers brought a group litigation action against the MET in respect of alleged unpaid overtime and failure to pay certain other allowances. The action was settled and, as part of the settlement agreement, certain amounts were paid for the account of Mr Murphy (and the other officers) which related to certain legal expenses of the claimants and the cost of insurance against a possible liability to legal costs of the MET should the claim fail.

3. The issue in this appeal is whether those amounts constitute employment income for income tax purposes.

4. Initially, the second ground of appeal related to the payment of interest but I was informed that that issue was no longer in dispute and I shall say nothing more about it.

THE FACTS

5. The facts in this appeal were not in dispute and were as follows.

6. On 19 December 2014 Mr Murphy and a number of other police officers commenced group litigation proceedings in the High Court against the MET for unpaid overtime, and Away from Home and Hardship allowances (referred to as "**Hardship allowances**"). A further smaller number of police officers were added as claimants by an order of 2 October 2012. I shall refer to the Mr Murphy and the other claimants in the legal proceedings together as "**the Claimants**".

7. To fund the legal proceedings against the MET, each of the Claimants entered into a Damages-Based Agreement with solicitors Simons Muirhead & Burton ("**SMB**") and Jonathan Davies of Counsel. Under the terms of the agreement SMB and Jonathan Davies would act as solicitors and counsel respectively for the Claimants in return for a "**Success Fee**" which was calculated as a percentage of any sum paid by the MET to settle the claim or any damages awarded to the Claimants by the High Court.

8. Each of the Claimants also entered into an insurance contract with Temple Legal Protection Limited ("**Temple**"). Under the terms of the insurance contract Temple insured the Claimants against the risk of having to pay the MET's legal costs if the Claimants lost all or part of their claim in return for a premium.

9. The MET denied any and all liability for overtime or Hardship allowances claimed by the Claimants.

10. On 5 May 2016 the MET entered into a Settlement Agreement ("**the Settlement Agreement**") with the Claimants. The relevant clauses of the Settlement Agreement are set out in the Appendix to this Decision. For convenience, I shall, however, summarise the main provisions of the Settlement Agreement.

11. The recital to the Settlement Agreement, under the heading "Background" stated as follows:

> "The Claimants lodged a claim in the Queen's Bench Division … on 19 December 2014… claiming pay for unpaid overtime, an entitlement to receive

> the Away from Home and Hardship Allowances and a declaration regarding the entitlement to the payment of unpaid overtime and Away from Home and Hardship Allowances. The Defendant disputed that the Claimants were entitled to any part of the Claim. A three-day liability trial is scheduled to take place as early as 9 May 2016 (the "Dispute"). The Parties wish to settle the Dispute and have agreed terms for the full and final settlement of the Dispute and wish to record those terms of settlement, on a binding basis, in this agreement."

12. Under the Settlement Agreement the MET agreed to pay the Claimants the sum of £4.2m (which was referred to as the "**Principal Settlement Sum**") plus Agreed Costs in full and final settlement of the Claimants' claims (clause 3.1). "**Agreed Costs**" were defined in clause 1 as the legal costs and disbursements plus VAT of the Claimants' solicitors and counsel as assessed by the Court or as agreed with the MET. The total of the Principal Settlement Sum and the Agreed Costs was referred to in the agreement as the "**Global Settlement Sum**" (clause 3.2).

13. Under clause 3.3 of the Settlement Agreement the MET agreed to make various payments as follows:

> "The defendant agrees to pay the Global Settlement Sum as follows:
>
> (a) the Firm will raise an invoice in the total sum of £1,200,000 ("being the Success Fee") addressed to the Claimants but stated to be payable by the Defendant, which will identify the amount payable to the Firm [SMB] and to counsel as agreed with the Claimants pursuant to the funding arrangement in place with the Claimants. Only once the Defendant has received this invoice will it pay the success Fee by electronic transfer to the Firm's office account … within 12 days of the date on which this agreement is signed by both Parties or the Defendant receives the invoice, whichever is later;
>
> (b) from the balance of the Global Settlement Sum, the Defendant will deduct £50,000 representing the insurance premium payable to Temple Legal Protection Limited ("Temple") pursuant to an insurance contract between each of the Claimants and Temple. The Defendant will agree to pay this sum to Temple within 12 days of the date on which this agreement is signed by both Parties or the Defendant receives a letter from Temple confirming the amount of the insurance premium due, whichever is later;
>
> (c) from the remaining balance of the Global Settlement Sum, the Defendant will pay to each of the Claimants as contained in an Apportionment Spreadsheet sent to the Defendant by the Firm, such sums to be subject to the withholding of income tax and National Insurance contributions. For the avoidance of doubt, the said withholdings are to be made on the basis of the Principal Settlement Sum and not the balance of the Global Settlement Sum. The payments to be made pursuant to this clause 3.3(c) are to be made in the first monthly payroll which follows receipt by the Defendant of the Claimants' Apportionment Spreadsheet."

14. It will be noted that under clause 3.3(c) of the Settlement Agreement it was provided that the MET proposed to treat the whole of the Principal Settlement Sum as being subject to PAYE and to deduct tax accordingly. Under clause 7.1 the MET agreed to co-operate with any of the Claimants who disputed the MET's proposed tax treatment.

15. Under clause 5.1 each party released the other party from all claims in relation to the Dispute and the Settled Claim.

16. Clause 8 dealt with costs and provided:

> "8. COSTS

> 8.1 Other than the Agreed Costs, the Parties shall each bear their own legal costs in relation to the Dispute and this agreement."

17. No admission of liability to pay overtime or Hardship allowances was made by the MET (clause 11).

18. The Principal Settlement Sum was apportioned between the Claimants on the basis of length of service since 20 December 2008 (overtime claim) and 1 April 2012 (Hardship allowances claim). No distinction was made between those Claimants who were entitled to overtime and those who were not because they were not Inspectors.

19. I was shown a memorandum dated 29 April 2016 from SMB to the Claimants. This memorandum described the pros and cons of the proposed £4.2 million settlement amount and in paragraph 4 stated:

> "However, the MET has informed us that it will tax the entire amount of the settlement sum (i.e. it will tax the success fee) and after that, it will deduct the success fee which is payable to your legal team. This approach is less tax efficient for you. This would decrease the size of the pot available to the Claimants. We have told this to the MET and in reply the MET has increased its settlement offer to £4.2 million plus costs.
>
> We sought independent tax advice from a tax specialist Barrister …. The tax Barrister has advised that the success fee and legal costs are not taxable. In effect, his position reflects your legal team's position and this is good news. We have sent this advice to the MET. However, what it risks is that the MET may decide to reduce its offer from £4.2 million to £4 million plus costs if it decides to follow the tax advice and NOT tax the success fee. If this does happen, the Executive Committee[1] has authorised me to confirm that they recommend you agree to settle at £4 million plus costs.

20. I was also shown the agreement between JMB, Mr Davies and one of the Claimants, which I understood to be typical of the agreement entered into between JMB, Mr Davies and all the claimants. Under that agreement the Claimants agreed to pay JMB, net of any costs and expenses which were paid or payable by the MET, 40% (inclusive of VAT) of any sum of money which the MET "agrees to pay pursuant to a settlement…." I was informed that, in the event, the percentage was reduced by agreement to 30%.

21. Mr Murphy filed his 2017 tax return on the basis that none of the Principal Settlement Sum was his income for that year.

22. The tax return was made following correspondence between Mr Murphy's advisers and HMRC in which HMRC stated that the Principal Settlement Sum was not income of the 2017 tax year and should be spread over the period in respect of which the claims were made.

23. HMRC opened an enquiry into Mr Murphy's tax return but on 12 March 2018 issued a closure notice making no amendments to the return. Also, on 12 March 2018, HMRC raised discovery assessments for the tax years 2009 to 2016. The discovery assessments assessed the Mr Murphy on his apportioned share of the Principal Settlement Sum (including the Success Fee and insurance premium) and to interest.

24. Mr Murphy appealed against the discovery assessments on two grounds. The first ground was that the payment of Mr Murphy's apportioned share of the Success Fee and insurance premium was not his earnings. The second round was that under the PAYE Regulations (SI

[1] a committee established from amongst the Claimants

2003/2682) the MET not the Appellant was liable to pay tax to HMRC in respect of the amounts assessed by the discovery assessments. I understand that the second ground is not before me.

RELEVANT STATUTORY PROVISIONS

25. Sections 6 and 7 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA") relevantly provide:

> "**6 Nature of charge to tax on employment income**
>
> (1) The charge to tax on employment income under this Part is a charge to tax on—
>
> (a) general earnings, and
>
> (b) specific employment income.
>
> The meaning of "employment income", "general earnings" and "specific employment income" is given in section 7.
>
> (2) The amount of general earnings or specific employment income
>
> which is charged to tax in a particular tax year is set out in section 9.
>
> …
>
> **7 Meaning of "employment income", "general earnings" and "specific employment income"**
>
> (1) This section gives the meaning for the purposes of the Tax Acts of "employment income", "general earnings" and "specific employment income".
>
> (2) "Employment income" means—
>
> (a) earnings within Chapter 1 of Part 3,[see section 62 below]
>
> (b) any amount treated as earnings (see subsection (5)), or
>
> (c) any amount which counts as employment income (see subsection (6)).
>
> …
>
> (4) "Specific employment income" means any amount which counts as employment income (see subsection (6)), excluding any exempt income.
>
> …
>
> 9 **Amount of employment income charged tax**
>
> …
>
> (2) In the case of general earnings, the amount charged is the net taxable earnings from an employment in the year.
>
> **62 Earnings**
>
> (1) This section explains what is meant by "earnings" in the employment income Parts.
>
> (2) In those Parts "earnings", in relation to an employment, means—
>
> (a) any salary, wages or fee,
>
> (b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or
>
> (c) anything else that constitutes an emolument of the employment.

> (3) For the purposes of subsection (2) "money's worth" means something that is—
>
> (a) of direct monetary value to the employee, or
>
> (b) capable of being converted into money or something of direct monetary value to the employee.
>
> (4) Subsection (1) does not affect the operation of statutory provisions that provide for amounts to be treated as earnings (and see section 721(7))."

SUBMISSIONS IN OUTLINE

26. Mr Carey, appearing for HMRC, submitted that under the Settlement Agreement the Principal Settlement Sum was paid "in full and final settlement of the Settled Claim." The "Settled Claim" was defined in clause 1 the Settlement Agreement as being for unpaid Hardship allowances and overtime.

27. Therefore, in Mr Carey's submission it could not be said that the sum of £4.2 million was paid for anything other than the unpaid overtime and various allowances because that was all that the Settled Claim comprised.

28. Further, Mr Carey argued that the Settlement Agreement, having identified that the Principal Settlement Sum, was paid for the unpaid overtime and various allowances, then set out various deductions from that sum which were to pay the lawyers and insurers in clause 3.3 (a) and (b). The remainder of clause 3.3 (c) then dealt with how the remaining balance of the Principal Settlement Sum must be paid to the Claimants, including Mr Murphy. Clause 3.3 (c) also made it clear that any withholding of tax would be based on the Principal Settlement and not on the balance of the Global Settlement Sum.

29. Mr Carey submitted that the fact that deductions from the Principal Settlement Sum had been diverted to the payment of the lawyers' success fee and Temple's insurance premium did not change the original character of the payment as earnings.

30. Mr Carey referred to the decision of the House of Lords in *Laidler v Perry (Inspector of Taxes)* [1965] 2 All ER 121 and, in particular, the speech of Lord Reid at 124.

31. It was clear, Mr Carey argued, both from the substance of the Claim and the Settlement Agreement, that the profit was from Mr Murphy's employment. He would not have been entitled to any of the profit under the agreement but for his job as a police officer. In addition, Mr Murphy's entitlement to the unpaid overtime and Hardship allowances was directly derived from his employment.

32. Moreover, Mr Carey pointed to the memorandum dated 29 April 2016 from SMB to the Claimants. This showed that tax had already been taken into account when the MET increased its offer to £4.2 million.

33. Mr Collins, appearing for Mr Murphy, argues that the Success Fee and the insurance premium were not taxable as earnings.

34. In relation to section 62 ITEPA, Mr Collins explained (and this was common ground) that the purpose of section 62(2)(c) was to ensure that pre-ITEPA case-law continue to apply.

35. Further, Mr Collins submitted that the Success Fee and Temple's insurance premium were not salary, wages or fee or a gratuity for the purposes of section 62 (2)(a) and (b). Thus, according to Mr Collins, the Success Fee and the insurance premium could only be taxable earnings if they constituted a profit or incidental benefit of any kind within section 62(2)(b).

36. Mr Collins placed considerable reliance on the decision of the House of Lords in *Hochstrasser (HMIT) v Mayes* [1960] AC 376 ("*Hochstrasser*") and the comments of Lord Denning at 396. The Claimants did not, Mr Collins argued, make a profit of £4.2 million from their employment in circumstances where, from that amount, £1.2 million (the Success Fee) and £50,000 (the insurance premium) were paid directly by the MET to SMB and Temple respectively.

37. Furthermore, using the language employed in *Hochstrasser*, Mr Collins submitted that although the Claimants would not have received the Principal Settlement Sum but for the fact that they were employees of the MET (i.e. the *sine qua non* test), this was not enough to treat the sums thereby received as earnings. Instead, it was necessary for HMRC to show that the real cause of the payment (the *causa causans* or the active cause) was the employment relationship, in the sense that the payment was a reward for services, rather than the Settlement Agreement. Mr Collins submitted that the source of the payment was the Settlement Agreement: the immediate cause of the payment was the claim brought against the MET and its settlement. The payment of the Principal Settlement was not a reward for services – it was a sum paid to settle a claim – and the payment of the Success Fee and insurance premium represented costs incurred by the Claimants in bringing an action against the MET. The only "profit" in the sense used in section 62(2)(b) was the sum of £2.95 million not £4.2 million.

38. Mr Collins also referred to the observations of Viscount Simonds in *Hochstrasser* at 390 where it was said that in determining whether a payment constituted employment income, the question was "one of substance, not form". Mr Collins argued that the substance, in this case, was that the Claimants made a profit of £2.95 million not £4.2 million.

39. Finally, Mr Collins referred to the decision of Finlay J in *Eagles v Levy* 19 TC 23. In that case, Finlay J considered that if an agreed settlement amount included costs then the element reflecting costs would not be taxable as employment income. Mr Collins submitted that in the present case it was clear that the Principal Settlement Sum included the Success Fee and insurance premium. Although the case was distinguishable on the facts, the principle established in *Eagles v Levy* was equally applicable in the present case.

THE AUTHORITIES

40. There are few areas of tax law which have provoked more judicial comment and discussion than the question whether a payment made to or for the account of an employee constitutes employment income. I shall, therefore, not attempt to summarise every applicable authority regarding the question of whether a payment is derived "from an employment".

41. Many of those cases draw fine distinctions between payments that were held to be chargeable to tax and those that were not.

42. The present position is best summed up by the words of Lord Reid in *Laidler v Perry* (42 TC 351)[2], where he said (at page 363):

> "There is a wealth of authority on this matter, and various glosses on or paraphrases of the words in the Act appear in judicial opinions, including speeches in this House. No doubt they were helpful in the circumstances of the cases in which they were used, but in the end we must always return to the words in the Statute and answer the question - did this profit arise from the employment? The answer will be no if it arose from something else."

43. In *Bray v Best* (61TC104) Lord Oliver addressed the "reward for services" terminology, used in the earlier cases, as follows:

[2] Cited with approval in *Shilton v Wilmhurst* 64 TC 78 and *Brumby (Inspector of Taxes) v Milner* [1976] UKHL.

> "'In the light of those authorities, I cannot read the phrase "reward for services" as anything more than a conventional expression of the notion that a particular payment arises from the existence of the employer-employee relationship and not, to use Lord Reid's words in *Laidler v Perry*, from "something else"."

44. In *Shilton v Wilmshurst* 64 TC78, Lord Templeman explained the statutory words in this way:

> "An emolument 'from employment' means an emolument 'from being or becoming an employee'. The authorities are consistent with this analysis and are concerned to distinguish in each case between an emolument which is derived 'from being or becoming an employee' on the one hand, and an emolument which is attributable to something else on the other hand. "

45. More recently, Patten LJ in *Kuehne & Ors v HMRC* [2012] EWCA Civ 34 has summarised the authorities and gave helpful guidance as to the decision-making process to be followed:

> 49. The issue on this appeal is whether the payments constituted "earnings from an employment": see s.9(2) ITEPA. It is conceded that they were "earnings" as defined in s.62(2) if they were from the employment. On that basis, they were clearly an "other profit or incidental benefit" or an "emolument"….
>
> 50. What constitutes an emolument or other benefit from an employment has been the subject of judicial analysis for almost 100 years. As Mummery LJ has explained in his judgment, our task is to apply the statutory test to the facts found and not to apply some other test based on a gloss: see e.g. *Hochstrasser v Mayes* [1959] 38 TC 673 per Lord Radcliffe at p. 707. But some gloss is inevitable because it is accepted that it is not enough merely to show that the payment was received as an employee and would not have been received if the individual had not been an employee. Something more must be established. This has been expressed in terms of the difference between *causa sine qua non* and *causa causans*[3] but it does, on any view, require a sufficient causal link to be established between the payment and the employment.
>
> 51. The ways in which that necessary link has been described and analysed in the earlier cases does, I think, have to be respected even though the ultimate question is whether the "from" question can be answered in the affirmative. Neill LJ in *Hamblett v Godfrey* [1986] 59 TC 694 at p. 726 G-H describes those explanations as valuable and authoritative. And what the cases, I think, show is that the question of taxability involves one being able to characterise the payment as one "from employment" if it derives "from being or becoming an employee" and is not attributable to something else such as a mark of esteem or a desire to relieve distress. I take this formulation from Lord Templeman in *Shilton v Wilmshurst* [1988] 64 TC 78 at p. 105 G-I because this is how the words "from employment" were construed and that decision is, I believe, binding on us in that respect. The same test was adopted by Lord Reid in *Laidler v Perry* [1966] 42 TC 351 at p. 363 and by Lord Kilbrandon in *Brumby v Milner* [1975] 51 TC 583 at p. 614.

[3] the use of this terminology was heavily criticised by Lord Simon of Glaisdale in *Brumby v Milner* [1975] 51 TC 583 at p. 614. With respect to Lord Simon, in *Hochstrasser v Mayes*, where this terminology was used, the House of Lords was faced with the question whether it was enough to establish taxability if the payment would not have been made *but for* the fact that the taxpayer was an employee. It seems to me that the judgment in *Hochstrasser v Mayes* and in particular the use of the words *causa causans* was simply an attempt to establish whether the employment was the true source of the payment or whether the payment was attributable to "something else".

> 52. It must follow from this that, in order to satisfy the s.9 test, one must be able to say that the payment is from employment rather than from a non-employment source. This has certainly been the approach of the courts in most of the decided cases, examples of which are:
>
> (i) Viscount Simonds in *Hochstrasser v Mayes* at p. 705/706 "often difficult to draw the line and say on which side of it a particular case falls";
>
> (ii) Lord Wilberforce in *Brumby v Milner* at p. 612 "not an easy question to answer";
>
> (iii) Lord Diplock in *Tyrer v Smart* [1979] STC 34 at p. 36 c-d: "determination of what constitutes his dominant purpose"; and
>
> (iv) Carnwath J in *Wilcock v Eve* [1994] 67 TC 233 at p. 232A: where there is more than one operative cause "there is an element of value judgment in deciding on which side of the statutory line the payment falls".
>
> 53. This process of evaluation requires the fact-finding judge to make findings of primary fact based on the evidence as to the reasons and background to the payment and then to apply a judgment as to whether the payment was from the employment rather than from something else. To this extent, I agree with the appellants so far as they submit that having determined the causes of the payment that process of characterisation must then follow. The interpretation of the words "from employment" by the House of Lords in the cases referred to makes that an inevitable step in answering the statutory question. Although this is the only question (see Russell LJ in *Brumby v Milner* at p. 608), it still has to be answered."

46. There are two more authorities with which I should deal.

47. The first is a decision of this Tribunal in *A v Revenue and Customs Commissioners* [2015] SFTD 678 (Judge Raghavan and Ms O'Neill). The employee believed that he had been less favourably treated by his employer in terms of salary and annual bonuses because of his ethnic origin. The employee raised these issues with his employer and eventually agreed to an additional lump sum of £600,000 under a compromise agreement. HMRC considered that the £600,000 payment was chargeable to tax as earnings under section 62 ITEPA. The Tribunal held that where damages were calculated by reference to underpaid earnings, while the discrimination may have manifested itself through the way the employee was remunerated, the damages arose not because the employee was under-remunerated but because the underpayment was discriminatory. An award in those circumstances could not be regarded as a reward for services. The award was paid for some other reason than employment and was not earnings. The Tribunal held at [81]:

> "It could be said that where the complaint is of underpayment of remuneration that the damages would not have arisen if it were not for the fact the claimant was an employee but it is clear that it is not enough. That sort of wide test of causation (a 'but for' test) is insufficient (see *Hochstrasser (Inspector of Taxes) v Mayes* [1959] 3 All ER 817, [1960] AC 376). When we pose the question: 'Why did the employee receive the payment?' the answer is not that it was in return for the employee's services but because it has been determined that the employer has acted unlawfully by discriminating against the employee. Where damages are calculated by reference to underpaid earnings, while the discrimination may have manifested itself through the way in which the employee was remunerated, the damages arise not because the employee was under-remunerated but because the underpayment was discriminatory. An award in these circumstances cannot in our view be described as a reward for services. The award is paid for some reason other than the employment and is

> not earnings. (The extent to which the non-taxability of the damages is taken account of in determining the amount of the compensation award would of course be a matter for the employment tribunal making the award to determine in accordance with the relevant law.)"

48. I think this case is an example of where the taxpayer successfully established that the true source of the payment was not from his employment but from a non- employment source i.e. a breach of his statutory rights.

49. The second authority is the decision of the High Court in *Eagles v Levy* 19 TC 23. In that case the taxpayer brought an action in the High Court in respect of unpaid remuneration from his position as managing director. The action was settled upon the terms that £45,000 was to be paid by the employer to the taxpayer. The Inland Revenue assessed the taxpayer on the payment of £45,000 as employment income. The taxpayer argued that the payment of £45,000 was an agreed sum to cover his claim for remuneration and his costs and expenses and that the amount of those costs and expenses was not assessable to income tax. The General Commissioners found in favour of the taxpayer, reducing the assessment by the amount of the taxpayer's costs, although the basis on which they did so was unclear. Finlay J examined what was said to the High Court in respect of the settlement (at page 31):

> "[Counsel for the employer:] We propose to pay him a sum of £45,000 to include everything…. But [the parties] have now come to what I hope your Lordship will think is the most sensible and proper arrangement; that is to pay that sum to [the taxpayer] and on those terms to put an end to all the proceedings. The sum of £45,000 is a comprehensive sum; there are no costs on either side of the matter."

50. Finlay J, allowing HMRC's appeal, said (at page 31):

> "It seems to me that, when one reads that, one sees that it is quite definite that there is a sum of £45,000 and that, as plainly as possible, costs are excluded from that so as to form no part of it. After all, one cannot entirely neglect this aspect of the matter. If now I were to hold that £5000 or £6000, or whatever it was, was costs of the action, that would mean that the directors *pro tanto* were paying the costs. That seems to me to be exactly what great pains were taken to prevent. I think, therefore, accepting as I do accept – and this point is the only point which gives me the least difficulty – the test which [counsel for the taxpayer] put to me, and taking, as I do, the view that this was a question of fact upon which, if there was evidence, the Commissioners were entitled to find, I arrive at the conclusion that on the materials before them they could arrive only at one conclusion, which is that this £45,000 did not to any extent represent costs but, on the contrary, was a sum from which costs were, with rather meticulous care, excluded. It therefore results that I am unable to think that the decision of the Commissioners can be supported on either of the grounds, on one of which they must be taken to have made it, and the appeal of the Crown is allowed."

DISCUSSION

51. The issue in this case is whether the payment of the Success Fee and Temple's insurance premium, using the language of Lord Reid in *Laidler v Perry*, arose from Mr Murphy's employment or from something else.

52. In my judgment the payment of those amounts arose from Mr Murphy's employment. It seems to me that the terms of the Settlement Agreement make this plain.

53. The definition of "Settled Claim" makes it clear that the Claimants were bringing a claim in respect of unpaid allowances and overtime, to which they claimed they were entitled, against

their employer. Had the MET paid the allowances in the first place, it was not disputed that those payments would have constituted taxable earnings. Clause 3.1 provides that the Principal Settlement Sum of £4.2 million plus Agreed Costs (the aggregate amount being referred to as the Global Settlement Sum) was paid in full and final settlement of the Settled Claim.

54. The definition of "Agreed Costs" in clause 1 provided that it covered the legal costs (including disbursements) plus VAT of the Claimants' solicitors and the legal costs plus VAT of the Claimants' Counsel incurred by the Claimants in the Dispute (as described in the Recital to the agreement), as assessed by the Court or as agreed with the Defendant. It was common ground that the sum payable in respect of Agreed Costs was not taxable as earnings – it was paid in respect of "something else" i.e. the costs incurred in the action.

55. Clause 8.1 of the Settlement Agreement stated that:

> "Other than the Agreed Costs, the Parties shall each bear their own legal costs in relation to the Dispute and this agreement."

56. The effect of clause 8.1, it seems to me, is that the Principal Settlement Sum of £4.2 million did not include a payment in respect of costs. Instead, it constituted a payment in settlement of the claim for unpaid allowances and overtime which, as I have said, would have been taxable earnings if they had been paid in the first place.

57. Thus, this case closely resembles the facts in *Eagles v Levy*. In that case the £45,000 paid to the taxpayer was, as Finlay J found, expressly agreed not to include costs. In the present case, as I have said, the effect of clause 8.1 is that the Principal Settlement Sum of £4.2 million similarly did not include costs.

58. I think it follows, therefore, that the amount of £4.2 million was derived from Mr Murphy's employment and not, as Lord Reid to put it, "from something else." The payment of £1.2m under clause 3.3(a) represented employment income which was paid away in the discharge of Mr Murphy's (and the other Claimants') liability to JMB and Mr Davies under the Damages-based Agreement.

59. I appreciate that clause 8.1 did not apply to Temple's insurance premium. Nonetheless, I do not read the Settlement Agreement as meaning that the amount of £4.2 million was paid, at least in part, in respect of the insurance premium or in respect of costs. As I read clause 3.3, which provided for the way in which the Global Settlement Sum should be paid, it simply set out an order of priority in which (and clarified to whom) the sums therein mentioned should be disbursed. It did not, in my view, alter the underlying character of the amounts of money being paid by the MET to or for the account of the Claimants.

60. Furthermore, I do not think my conclusions are altered by appeals to "substance". I recognise and accept that the question whether Mr Murphy received earnings within the meaning of section 62 ITEPA is one of substance rather than form, as Viscount Simonds held in *Hochstrasser*. Nonetheless, I think that the Settlement Agreement, as I have analysed it above, did indeed represent the substance of the arrangement between the MET and the Claimants, including Mr Murphy.

61. Finally, although many of the older authorities referred to emoluments being derived "from" the employment, section 62(2)(c) refers to emoluments "of" an employment. It was not suggested to me, rightly in my view, that anything turned on this minor difference in wording. In any event, section 9(2) provides that the amount of general earnings to be charged to tax is the net taxable earnings "*from* an employment" in the year, putting the matter beyond doubt.

62. For these reasons, the appeal is dismissed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

63. 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.

GUY BRANNAN
TRIBUNAL JUDGE

Release date:

APPENDIX

Terms of Settlement Agreement

The material provisions of the Settlement Agreement were as follows:

"**1. DEFINITIONS AND INTERPRETATION**
…

Agreed Costs: the legal costs (including disbursements) plus VAT of the Claimants' solicitors being Simons Muirhead & Burton [the "Firm"] and the legal costs plus VAT of the Claimants' Counsel being Jonathan Davies, incurred by the Claimants in the Dispute, as assessed by the Court or as agreed with the Defendant.
Apportionment Spreadsheet: a spreadsheet containing the gross sums payable to the Claimants, which represents their individual pro-rated entitlements in relation to the balance of the Global Settlement Sum after first deducting the Success Fee.
…
Settled Claim: being only the claims for payment of Away from Home and Hardship allowances from the period of 1 April 2012 until the date of issue of the claims; and the claims for declarations regarding the entitlement to the payment of unpaid overtime and Away from Home and Hardship allowances; and any claim for the payment of overtime from the date of issue of proceedings until the date of settlement; and any claim for the payment of Away from home and Hardship allowances from the date of issue of proceedings until the date of settlement.
Success Fee: the global sum of £1.2 million payable to the Firm and Counsel pursuant to the funding arrangement in place between the Claimants, the Firm and Counsel.
…

3. PAYMENT
3.1 In exchange for the Claimants agreeing to the full and final settlement of the Settled Claim, the Defendants shall pay to the Claimants a total sum of:

(a) £4.2 million ("**Principal Settlement Sum**"); plus
(b) Agreed Costs.

3.2 The total of the Principal Settlement Sum plus Agreed Costs is referred to

below as the "**Global Settlement Sum**".

3.3 The Defendant agrees to pay the Global Settlement Sum as follows:

(a) The Firm will raise an invoice in the total sum of £1,200,000 ("being the **Success Fee**") addressed to the Claimants but stated to be payable by the Defendant, which will identify the amount payable to the Firm and to Counsel as agreed with the Claimants pursuant to the funding arrangement in place with the Claimants. Only once the Defendant has received this invoice will it pay the Success Fee by electronic transfer to the Firm's office account (using account details: sort code [redacted] and account no: [redacted]) within 12 days of the date on which this agreement is signed by both Parties or the Defendant receives the invoice, whichever is later;

(b) from the balance of the Global Settlement Sum, the Defendant will deduct £50,000 representing the insurance premium payable to Temple Legal Protection Limited ("**Temple**") pursuant to an insurance contract between each of the Claimants and Temple. The Defendant will agree to pay this sum to Temple within 12 days of the date on which this agreement is signed by both Parties or the Defendant receives a letter from Temple confirming the amount of the insurance premium due, whichever is later;

(c) from the remaining balance of the Global Settlement Sum, the Defendant will pay to each of the Claimants as contained in an Apportionment Spreadsheet sent to the Defendant by the Firm, such sums to be subject to the withholding of income tax and National Insurance contributions. For the avoidance of doubt, the said withholdings are to be made on the basis of the Principal Settlement Sum and not the balance of the Global Settlement Sum. The payments to be made pursuant to this clause 3.3(c) are to be made in the first monthly payroll which follows receipt by the Defendant of the Claimants' Apportionment Spreadsheet.
…

4. STAY OF ACTION
The parties hereby consent to, and shall take all necessary steps to obtain an Order in substantially the form of the draft Consent Order in Annex A.[4]

5. RELEASE
5.1 This agreement is in full and final settlement of, and each party hereby releases and forever discharges, all and/or any actions, claims, rights, demands and set-offs, whether in this jurisdiction or any other, whether or not presently known to the Parties or to the law, or whether in law or equity, that it, its Related Parties or any of them ever had, may have or hereafter can, shall or may have against the other party or any of its Related Parties arising out of:

[4] A consent order was obtained in the following terms: "1. The Claimant and the Defendant having agreed to the terms set out in the Confidential Schedule, IT IS ORDERED THAT all further proceedings in this claim be stayed except for the purpose of carrying such terms into effect. 2. Liberty to apply as to carrying such terms into effect. 3. Costs to be subject to detailed assessment if not agreed."

the Dispute;

the Settled Claim

(collectively the "Released Claims")

7. PROMPT CO-OPERATION FROM THE DEFENDANT

7.1 The Defendant agrees to provides prompt co-operation with any of the Claimants listed in Schedule 1 to this agreement or their representatives in the event that any of the Claimants wish to dispute the Defendant's proposed tax treatment of the Principal Settlement Sum, such co-operation to include, non-exhaustively, providing access to relevant paperwork at no cost to the Claimant(s) and answering questions raised by the Claimant or their representatives or Her Majesty's Revenue & Customs ("HMRC") relating to the taxation of the Principal Settlement Sum. Such co-operation to be provided by or on behalf of the Defendant promptly and without unreasonable delay.

…

8. COSTS

8.1 Other than the Agreed Costs, the Parties shall each bear their own legal costs in relation to the Dispute and this agreement.

8.2 This clause 8 supersedes and overrides any and all previous agreements between the Parties and any court order regarding the legal costs in relation to the Released Claims and in relation to this agreement (including the implementation of all matters provided by this agreement).

…

11. NO ADMISSION

This agreement is entered into in connection with the compromise of disputed matters and in the light of other considerations. It is not, and shall not be represented or construed by the Parties as, an admission of liability or wrongdoing on the part of either party to this agreement or any other person or entity."