[2016] UKUT 0013 TCC
Appeal number: UTC/2014/0066

INCOME TAX - termination of employment – payment of £200,000 made under compromise agreement signed after termination - whether payment within Chapter 3 of Part 6 of ITEPA 2003 and chargeable to income tax - whether payment received in connection with termination of employment within section 401 ITEPA - yes - whether damages for injury to feelings payment on account of injury to employee within section 406 ITEPA - no - whether Appellant can rely on 'concession' by HMRC to reduce amount chargeable to income tax - no - appeal dismissed

Walker v Adams, Oti-Obihara v HMRC, Orthet Ltd v Vince-Cain and Timothy James Consulting Ltd v Wilton considered

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

KRISHNA MOORTHY

Appellant

- and –

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: The Hon Mrs Justice Rose DBE
Chamber President
Judge Greg Sinfield

Sitting in public in London on 26 - 28 October 2015

David Gray-Jones, solicitor advocate, of Thomas Mansfield Solicitors Limited for Mr Moorthy

John Brinsmead-Stockham, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This appeal concerns the extent to which a payment made by an employer to settle a claim for unfair dismissal and age discrimination made by an employee following the termination of his employment by reason of redundancy falls to be treated as employment income by sections 401 and 403 of the Income Tax (Earnings and Pensions) Act 2003 ('ITEPA') and is thus chargeable to income tax under section 6 of that Act.

2. In March 2010, the Appellant ('Mr Moorthy') was made redundant by his employer, Jacobs Engineering (UK) Limited ('Jacobs'). He received statutory redundancy pay of £10,640 in the 2009-10 tax year from which no tax was deducted. Mr Moorthy subsequently brought proceedings in the Employment Tribunal claiming unfair dismissal and age discrimination. Following mediation, Mr Moorthy and Jacobs entered into an agreement ('the compromise agreement') under which Jacobs agreed to pay Mr Moorthy "an ex gratia sum of £200,000 by way of compensation for loss of office and employment" ('the settlement amount'). Mr Moorthy was paid the settlement amount by Jacobs in two tranches in the 2010-11 tax year. Jacobs treated £30,000 of the settlement amount as exempt from tax by virtue of section 403 ITEPA and deducted income tax at the basic rate from the balance. Mr Moorthy completed his self-assessment tax return for 2010-11 on the basis that the settlement amount was tax free. The Respondents ('HMRC') did not agree and, in August 2013, issued a closure notice amending Mr Moorthy's self-assessment return for 2010-11[1] to include an additional £140,023 as taxable income.

3. Mr Moorthy appealed against the amendment to his return and his appeal subsequently came before the First-tier Tribunal ('the FTT'). In a decision released on 21 August 2014 under neutral citation [2014] UKFTT 834 (TC) ('the Decision'), the FTT (Judge Redston and Mrs Watts Davies) found that:

> (1) the settlement amount of £200,000 fell within section 401 ITEPA;
>
> (2) taking into account the statutory redundancy payment of £10,640 made in the 2009-10 tax year, the £30,000 exemption allowed by section 403 ITEPA was reduced to £19,360; and
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> (3) the FTT had no jurisdiction to allow a further relief of £30,000 treated by HMRC, as a concession, as damages for age discrimination and outside the charge to income tax.

4. Mr Moorthy now appeals, with permission of the FTT, against the Decision. The appeal raises three issues which are described more fully below. In brief, the first issue is whether the settlement amount was a payment in connection with the termination of employment within section 401 ITEPA to be treated, to the extent that it exceeds the £30,000 threshold in section 403, as employment income chargeable to income tax. If the settlement amount falls within the scope of section 401, the second issue is whether it is taken out of the charge to tax by section 406(b) ITEPA as a payment or benefit "on account of injury to … an employee", namely injury to feelings in the context of a

[1] Paragraph 4 of the Decision states that the amount was included as income for 2011-12 but this is clearly a slip.

discrimination claim. The final issue is whether Mr Moorthy can rely on the concession made by HMRC in the closure notice and at the hearing before the FTT that £30,000 of the settlement amount should be treated as damages for age discrimination and not chargeable to income tax. References below to numbers in square brackets are, unless otherwise apparent, references to paragraphs of the Decision.

5. For the reasons set out below, we have decided that the settlement payment falls within section 401 ITEPA, "injury" in section 406 does not include injury to feelings and Mr Moorthy cannot rely on the concession made by HMRC. Accordingly, Mr Moorthy's appeal against the Decision is dismissed.

Legislation

6. Part 2 of ITEPA imposes the charge to tax on 'employment income'. Section 6 ITEPA provides that the charge to tax on 'employment income' is a charge to tax on 'general earnings' and 'specific employment income'. Section 7 ITEPA provides that 'employment income' and 'specific employment income' both mean, among other things, any amount which counts as employment income by virtue of Part 6 of ITEPA.

7. Part 6 of ITEPA is entitled "Employment income: income which is not earnings or share-related". Chapter 3 of Part 6 is headed "Payments and benefits on termination of employment, etc". Chapter 3 contains sections 401 to 416. Section 401 is headed "Application of this Chapter" and provides as follows:

> "(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
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> (a) the termination of a person's employment,
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> (b) a change in the duties of a person's employment, or
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> (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 representatives.
>
> (2) Subsection (1) is subject to subsection (3) and sections 405 to 413 (exceptions for certain payments and benefits).
>
> (3) This Chapter does not apply to any payment or other benefit chargeable to income tax apart from this Chapter ..."

8. Section 403(1) ITEPA provides:

> "Charge on payment or other benefit
>
> (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."

9. The effect of section 403 ITEPA is that any payment above the £30,000 threshold which falls within section 401 is treated as employment income and is thus chargeable to income tax subject to any other allowances and reliefs. Section 403(4) provides that, in calculating the £30,000 threshold, all payments that fall within Chapter 3 must be aggregated in accordance with the rules in section 404. Section 404 provides, among other things, that such payments to an employee or former employee in respect of the same employment are to be aggregated even if they are received in different tax years.

10. Sections 405 to 413 ITEPA contain exceptions which provide that Chapter 3 of Part 6 of ITEPA does not apply to specified payments and benefits so that they do not count as employment income. Section 406, which was the subject of detailed submissions in this appeal, provides:

> "Exception for death or disability payments and benefits
>
> This Chapter does not apply to a payment or other benefit provided
>
> (a) in connection with the termination of employment by the death of an employee, or
>
> (b) on account of injury to, or disability of, an employee."

Factual background

11. There was no challenge to the findings of fact by the FTT. The facts that gave rise to the appeal can be summarised as follows:

(1) Prior to the termination of his employment, Mr Moorthy was employed by Jacobs as Executive Director of Operations and was a member of the company's Local Government Services Executive Management Team ('EMT'). He was paid a salary of £111,000 a year plus pension rights and a discretionary annual bonus in the form of shares depending on the performance of the business.

(2) On 4 February 2009, all members of the EMT were called to a meeting at which they were told that there was to be a restructuring and there would be fewer senior jobs. The EMT members would have to apply for the remaining posts and those who were not successful might be made redundant.

(3) Mr Moorthy did not obtain one of the new posts and, on 12 March 2009, he was told that he would be dismissed by reason of redundancy. Mr Moorthy had a twelve-month notice period. He was put on gardening leave for the whole of that period during which he was paid his normal salary but without any share bonus.

(4) On 12 March 2010, Mr Moorthy's employment was terminated. Subsequently, but before the end of the 2009-10 tax year, Jacobs paid Mr Moorthy statutory redundancy pay of £10,640 from which no tax was deducted.

(5) Before the meeting on 4 February 2009, Mr Moorthy had not experienced any discrimination while working at Jacobs. Following his dismissal, Mr Moorthy commenced proceedings in the Employment Tribunal ('the ET proceedings'), alleging unfair dismissal and age discrimination. The Complaint set out the events beginning with the meeting on 4 February 2009 and ending with Mr Moorthy's receipt of the dismissal letter. The Complaint included the following passages:

> "The Claimant further considers that his dismissal was unlawful as he was dismissed and/or selected for redundancy on the grounds of his age. The Claimant's dismissal therefore amounts to unlawful discrimination under Regulation 7 of the Employment Equality (Age) Regulations 2006.
>
> …
>
> It is submitted that the Claimant's appeal was not dealt with in a fair and reasonable way and that this, and in particular the failure to deal with the allegation of unlawful age discrimination in a meaningful and reasonable way, indicates that the Respondents were discriminating against the Claimant on the grounds of his age."

(6) Mr Moorthy sought the following remedies in the ET proceedings:

(a) declarations that he had been unfairly dismissed and that he had been unlawfully dismissed on the grounds of age;

(b) basic and compensatory awards;

(c) compensation for financial loss;

(d) an award for injury to feelings; and

(e) interest.

(7) In January 2011, Mr Moorthy and Jacobs engaged in mediation. Mr Moorthy's Statement of Case began by saying that he was claiming unfair dismissal and age discrimination. The Statement of Case alleged age discrimination during the redundancy selection process and stated:

> "If the age discrimination claim succeeds, the Claimant will be awarded damages for injury to feelings in the upper Vento range."

The "upper Vento range" is a reference to the guidance on the assessment of damages in discrimination cases given by the Court of Appeal in *Vento v Chief Constable of West Yorkshire Police* [2002] EWCA Civ 1871. The Court divided damages for injury to feelings into three bands. The appropriate level of damages for the most serious cases, eg where there has been a lengthy campaign of discriminatory harassment, was between £15,000 and £25,000. The guideline amounts were subsequently increased by the EAT in *Da'Bell v NSPCC* [2010] IRLR 19. The maximum which could have been awarded to Mr Moorthy under the updated *Vento* guidelines was £30,000.

(8) The mediation resulted in the compromise agreement under which Jacobs agreed to pay Mr Moorthy the settlement amount ("an ex gratia sum of £200,000 by way of compensation for loss of office and employment"). The payment was without admission of liability by Jacobs and was in full and final settlement of Mr Moorthy's claims made to the ET together with "any other claims" that the parties might have against each other "arising out of or connected with the employment or its termination". There was no allocation of the settlement amount to different heads of claim or otherwise. Jacobs paid the settlement amount to Mr Moorthy in the 2010-11 tax year. The compromise agreement stated that "the first £30,000 … will be paid to Mr Moorthy without deduction of income tax" and the balance would be subject to a 20% tax deduction. The compromise agreement also provided that Mr Moorthy would reimburse Jacobs any further tax which Jacobs was required to pay to HMRC in respect of the settlement amount.

(9) Mr Moorthy submitted his self-assessment tax return for the 2010-11 tax year online by the due date of 31 January 2012. Under "Pay from the employment", he entered £200,000 and, under "Tax taken off pay in Box 1", he entered £34,000. Mr Moorthy also entered £200,000 as "employment expenses". In the white space, he explained the background to the settlement payment and that he had received legal advice that the payment should be tax free. Mr Moorthy asked for a refund of the £34,000 deducted as tax.

(10) Following correspondence between Mr Gray-Jones, who has acted for Mr Moorthy throughout, and HMRC, HMRC opened an enquiry into Mr Moorthy's self-assessment tax return for 2010-11 on 22 October 2012. After further exchanges of correspondence, HMRC issued a closure notice on 13 August 2013.

The closure notice amended Mr Moorthy's self-assessment tax return for 2010-11 to remove the expenses of £200,000 and reduce the taxable income by the £30,000 threshold in section 403 ITEPA and a further £30,000 which, as a "concession and in order to try and reach agreement", HMRC offered to accept could be treated as damages for age discrimination in the "upper Vento range" and outside the charge to income tax.

(11) Mr Moorthy appealed the decision and asked for a statutory review. On 22 November 2013, HMRC confirmed the decision. Mr Moorthy submitted a notice of appeal against the closure notice to the FTT on 10 December 2013.

Decision of the FTT

12. In the Decision, the FTT first considered whether the settlement payment received by Mr Moorthy fell within section 401 ITEPA. In construing the section, the FTT applied the same analysis as the UT in *HMRC v Colquhoun* [2010] UKUT 431 (TCC) (*"Colquhoun"*). At paragraph [12] of that judgment, the UT observed in relation to section 148 of the Income and Corporation Taxes Act 1988 ('ICTA'), the predecessor to section 401, that:

> "The statutory language of section 148(2) has been broadly drawn. That can be seen from the use of words and phrases such as 'indirectly' and 'otherwise in connection with'. 'Otherwise' may simply mean 'in any way' and is consistent with the Parliamentary intention to catch a wide range of payments. … "

13. The FTT approached the question of whether the settlement payment fell within section 401 by analysing the facts as found. They included the fact that Mr Moorthy had not experienced any discrimination prior to being told he was at risk of redundancy and his complaint in the ET proceedings and the mediation related entirely to the circumstances of his dismissal. On the basis of their findings of fact, the FTT stated, at [67], that they had:

> "… no hesitation in finding that the payment of £200,000 in its entirety was made 'directly or indirectly in consideration or in consequence of, or otherwise in connection with' the termination of Mr Moorthy's employment, and therefore falls within ITEPA s 401."

14. The FTT held that, in the light of this finding, it was immaterial whether the settlement payment was also made to compensate Mr Moorthy for discrimination, unfair dismissal, injury to feelings, redundancy and/or financial loss. The FTT held that whether Jacobs made the settlement payment partly or entirely to protect its reputation was also irrelevant. The FTT gave their reason in [69]:

> "The payment can be any of these things, or all [of] them, but because it is 'directly or indirectly in consideration or in consequence of, or otherwise in connection with' the termination of Mr Moorthy's employment, it falls within ITEPA s 401. It is therefore unnecessary for us to respond to Mr Gray-Jones's arguments on how the £200,000 should be apportioned."

15. The FTT also considered various authorities which were relied on by Mr Gray-Jones. They were also the subject of submissions before us and we discuss them further below. Having reviewed the authorities, the FTT, in [112], confirmed their finding that the settlement payment was "received directly or indirectly in consideration or in consequence of, or otherwise in connection with" the termination of Mr Moorthy's

employment. Accordingly, the entirety of the settlement payment fell within section 401(1) ITEPA and was, therefore, liable to income tax under section 403(1).

16. Having concluded that the settlement payment fell within section 401 and thus Chapter 3 of Part 6 of ITEPA, the FTT went on to consider how much of the payment was taxable income of Mr Moorthy. That required the FTT to address three further issues. First, the FTT considered whether the redundancy payment of £10,640 made in the 2009-10 tax year counted towards the £30,000 threshold that was not subject to tax by virtue of section 403. The FTT held that the earlier redundancy payment received by Mr Moorthy in the 2009-10 tax year reduced the £30,000 threshold to £19,360. The FTT then addressed the effect of Jacobs treating £30,000 (ie the full amount of the threshold without taking account of the earlier redundancy payment) of the settlement payment as tax free and thus failing to deduct the correct amount of tax under the PAYE rules. The FTT held that Mr Moorthy was entitled to a credit for the basic rate tax of £2,128 which Jacobs should have deducted from the £10,640 but failed to do so. There is no appeal against the FTT's conclusions on these points.

17. The third issue was whether the taxable amount of the settlement payment should be reduced by the further £30,000 treated as damages by HMRC and excluded from the charge to tax in the closure notice as a concession. The FTT concluded that the further exemption of £30,000 had no statutory basis and they had no jurisdiction to allow relief in respect of the 'concession'.

18. As a result of their findings, the FTT increased the taxable income included in Mr Moorthy's self-assessment (as amended by HMRC) by £40,617, so that £180,640 of the settlement payment was included as taxable income in Mr Moorthy's self-assessment for the 2010-11 tax year.

Grounds of appeal

19. Mr Moorthy applied to the FTT for permission to appeal to the Upper Tribunal on five grounds ((a) to (e)). The FTT (Judge Redston) granted permission to appeal in a decision released on 29 October 2014. The FTT granted Mr Moorthy permission to appeal on (a), (d) and (e), which all related to whether the FTT had erred in concluding that the entirety of the settlement payment fell with section 401 ITEPA, because the FTT had come to a different conclusion to that of a differently constituted tribunal in *Oti-Obihara v HMRC* [2010] UKFTT 568 (TC) ('*Oti-Obihara'*). The FTT also gave permission to appeal on grounds (b) and (c), which concerned the scope of the FTT's jurisdiction to consider concessions by HMRC because there have been conflicting FTT decisions on the point.

20. Before us, Mr Gray-Jones sought to rely on two points that had not been argued in the FTT and for which permission to appeal had been neither sought nor granted. The first point was that the FTT had erred in not holding that part of the settlement payment was provided "on account of injury … to an employee", namely injury to Mr Moorthy's feelings, and thus fell within section 406 ITEPA and outside the charge to tax under section 403. The second point was that the approach taken by the FTT was contrary to the EU principles of equal treatment, equivalence and effectiveness.

21. In relation to the section 406 ground, we noted that the FTT had recorded, at [57], that:

> "Mr Gray-Jones confirmed that it was not part of his client's case that the payment fell within the exemption in ITEPA s 406 as being for injury or disability."

The FTT had also noted, at [68(2)], that Mr Gray-Jones had accepted that section 406 was not in point in Mr Moorthy's case. Nevertheless, the FTT discussed the Employment Appeal Tribunal ('EAT') case of *Orthet Ltd v Vince-Cain* [2005] ICR 374 ('*Orthet*') which concluded that injury to feelings came within section 406 ITEPA. At [92], the FTT stated that:

> "It is clear that ITEPA s 406 section *(sic)* does not encompass payments for injury to feelings. … To the extent that the EAT's decision [in *Orthet*] rests on its misreading of ITEPA, we respectfully consider it to be unreliable."

Mr Gray-Jones told us that he had not conceded that section 406 was not in point but had conceded that Mr Moorthy was not suffering from a 'disability' for the purposes of section 406. However, he acknowledged that he had not asked the FTT to correct those passages under rule 37 ('the slip rule') of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 when he applied for permission to appeal or at any other time.

22. Whether a payment in compensation for injury to feelings can fall within section 406 ITEPA is an important question on which different courts and tribunals have reached different conclusions. The Equality and Human Rights Commission ('EHRC') has intervened in this appeal and lodged written submissions on the issue. As the matter has not been considered by the Upper Tribunal previously and because Mr Moorthy, HMRC and the EHRC had provided detailed written submissions on the point, we decided that this case provided an opportunity for the Upper Tribunal to give some guidance on the meaning of 'injury' in section 406. This will reduce the risk of inconsistent results by different panels of the FTT in future cases. For that reason, we decided that, although reliance on section 406 had been disclaimed below and no permission to appeal on that ground had been given, we would allow Mr Gray-Jones to withdraw the concession recorded by the FTT that section 406 was not in point and argue the issue before us.

23. We did not consider that there was any reason to allow Mr Gray-Jones to argue the new EU law points before us. Although they were available, he had not put them forward in the FTT or included them in his application for permission to appeal. Although Mr Gray-Jones submitted that we were bound to ensure that our decision is consistent with EU law, we noted that the Court of Justice, in joined cases Case C-430/93 and C-431/93 *Jeroen van Schijndel and Johannes Nicolaas Cornelis van Veen v Stichting Pensioenfonds voor Fysiotherapeuten*, recognised that national courts are not required by Community law to raise an issue concerning the breach of Community law of their own motion where that is inconsistent with national law or practice.

24. It follows that there are three issues in this appeal, namely:

(1) whether the entirety of the settlement payment fell within section 401 ITEPA;

(2) whether "injury" in section 406 ITEPA includes injury to feelings; and

(3) what was the effect of the concession made by HMRC that £30,000 of the settlement payment should be treated as damages?

The EHRC's written submissions only address issues (1) and (2).

Case law - introduction

25. Before the FTT and before us, the parties referred to a number of authorities (some of which came after the hearing of this appeal by the FTT) that had considered sections 401 and 406 ITEPA, or earlier versions of those provisions, and which had reached different conclusions as to their proper interpretation.

Case law - section 401

26. Section 148 ICTA was the predecessor provision to section 401 ITEPA. Section 148(2) provided that the section applied to "any payment … which is made, whether in pursuance of any legal obligation or not, either directly or indirectly in consideration or in consequence of, or otherwise in connection with, the termination of the … employment."

27. The scope of section 148 was considered by a Special Commissioner in *Walker v Adams* [2003] SpC 344, [2003] STC (SCD) 269 ('*Walker*'). Mr Walker was employed by a company in Northern Ireland. After his employer was taken over by another company, Mr Walker suffered discrimination because of his religion. In 1994, he left the company in circumstances that amounted to constructive dismissal based on religious discrimination. The Fair Employment Tribunal in Northern Ireland awarded Mr Walker compensation of £77,446, of which £12,500 was specified to be for injury to feelings. The balance of £63,946 was in respect of net income loss, including future losses and pension rights. Mr Walker appealed against an assessment to tax the compensation under section 148 ICTA.

28. During the hearing of the appeal, the Inland Revenue withdrew their claim to tax the £12,500 attributable to injury to feelings. The decision records at page 271:

> "The Revenue accepted before me that the £12,500 awarded by the tribunal for injury to feelings was not a payment made 'in connection with' the termination of Mr Walker's employment."

Accordingly, the tax treatment of that part of the payment was not argued before the Special Commissioner and was not considered in the decision. However, the Special Commissioner observed, at page 273, that the withdrawal by the Revenue of its claim to tax the award in respect of injury to feelings was "rightly made." As it was not the subject of any argument and the Special Commissioner did not discuss the issue at all in the decision, we do not regard *Walker* as providing any support for the proposition that any part of a payment that is attributable to injury to feelings is not a payment made in connection with the termination of employment and thus is not subject to income tax.

29. In relation to the balance of £63,946, the Special Commissioner found that it was within section 148 of ICTA because:

> "… the unlawful discrimination founded the tribunal's jurisdiction and Mr Walker's right of action. The chain of causation seems to me to be clear. The discrimination caused the termination of Mr Walker's employment; the termination caused the financial losses; and those losses gave rise to the £64,946 award. The link between the payment and the termination is, to my mind, incontrovertible, and well within the wording of s 148(2). The word 'otherwise' shows that the relevant connection or link may be looser than would be required for a strict causation test."

30. Although the decision notes that the termination caused financial losses which led to the £64,946 award, that was not the reason for the Special Commissioner's decision in *Walker*. The Special Commissioner found that £63,946 was taxable because there was a link between the payment and the termination of the employment. In our opinion, there is nothing in section 148 ICTA or *Walker* that restricts the charge to tax to amounts paid in connection with the termination of employment only to the extent that they represent compensation for financial losses.

31. Section 401 ITEPA was also considered in *Crompton v HMRC* [2009] UKFTT 71 (TC), [2009] STC (SCD) 504 ('*Crompton'*). Mr Crompton was a soldier in the Territorial Army. From about 1988 he was employed by the regular army in a non-regular permanent staff post as a clerk. In 1992 or 1993 it was decided that the post would be 'civilianised' and he would not be eligible for it even if he left the army and re-applied as a civilian. Mr Crompton applied for various posts but was not appointed to any of them despite being suitably qualified. In February 1994, Mr Crompton took a post as a storeman in the army but, shortly after he had accepted that post, it was established that he was not sufficiently qualified, and that there was no way of obtaining the relevant qualifications. Mr Crompton took redundancy and left the army in February 1994. He was paid a redundancy payment. In December 1994, Mr Crompton applied to the army for redress and eventually in 2005 received "compensation for the actual financial losses he suffered as a consequence of the selection board failings". The issue in the appeal was whether the compensation was paid in connection with the termination of Mr Crompton's employment as a storeman or otherwise. The Special Commissioner found, at [31], that:

> "Mr Crompton left the army either of his own volition or by way of redundancy at the time of leaving the storeman post and not because of his failure to be selected for the posts he was not offered by the selection boards."

32. The Special Commissioner held, at [35], that:

> "A connection must be some sort of link, joint or bond between two things. Here there is no such link between the payment of compensation and the termination of Mr Crompton's employment with the army. The payment was for the selection board's unfair treatment of Mr Crompton but that did not lead to his leaving the army. He left the army because the storeman job came to an end in the circumstances already described."

33. In the absence of a connection between the damages paid to Mr Crompton on account of the failures of the selection boards and the termination of his employment, the Special Commissioner concluded that he should not be taxed on the compensation payment and allowed the appeal.

34. The next decision in relation to section 401 ITEPA is *Oti-Obihara* on which Mr Gray-Jones and the EHRC placed great reliance. The FTT in *Oti-Obihara* summarised the facts of the case and the points in issue succinctly in paragraph 2 of the decision:

> "The Appellant was employed by a US investment bank in London. In the course of his employment the Appellant claimed that he was subject to racial discrimination and harassment, and, after internal grievance procedures had been applied, eventually instituted proceedings against his employer before the employment tribunal. Before the matter came to a hearing at the employment tribunal the Appellant negotiated a

> settlement with his employer, whereby his employment was terminated, he waived all legal claims he might have against his employer, and he received a settlement sum of £500,000, which his employer paid after deducting income tax of £103,400. The Appellant did not include the payment of £500,000 in his self-assessment tax return on the grounds that it was not income from his employment nor a payment received in connection with the termination of his employment."

35. The FTT recorded at paragraph 18 that HMRC conceded that to the extent that any part of the Settlement Payment comprised damages for injury to Mr Oti-Obihara's feelings as a consequence of discrimination, then that was not taxable under section 401 ITEPA as a termination payment even if it was paid on the occasion of the termination of the employment contract. HMRC argued that the maximum compensation payable for injury to Mr Oti-Obihara's feelings under the *Vento* guidelines was £25,000 and were prepared to accept that £28,000 (ie the *Vento* maximum adjusted for inflation) of the settlement amount was not taxable. They submitted that the balance of the payment was compensation for discrimination. Relying on *Walker*, HMRC submitted that, as the discrimination was the cause of the termination of his employment, the balance was in connection with the termination and thus taxable.

36. The FTT, at paragraph 26 of its decision in *Oti-Obihara*, drew from *Walker* the conclusion that a compensation payment made by an employer to an employee for discrimination is taxable under section 401 ITEPA if the discrimination is the cause of the termination of the employment only to the extent that the compensation meets financial losses caused by the termination. The FTT rejected Mr Oti-Obihara's argument that the discrimination suffered by him was unrelated to the termination of the employment but found that the termination occurred because the relationship of employer and employee could not be sustained due to a loss of trust between them. Having made that finding, the FTT stated:

> "31. If the nexus between the discrimination and the termination of the employment is established, the *Walker* case shows that a compensation payment made on the occasion of the termination of employment for discrimination is taxable to the extent that it is compensation for financial loss suffered by reason of the termination of the employment - only to that extent is a payment received in connection with the termination of the employment. Any other amount received by reason of discrimination represents compensation for the infringement of the right not to be discriminated against, not compensation for the termination of the employment."

37. The FTT in *Oti-Obihara* found, in paragraph 34, that the settlement payment was made both in connection with the termination of the employment and also in relation to claims by Mr Oti-Obihara for violations by his employer of his rights which were additional to those connected with the termination of his employment. The FTT did not accept HMRC's approach to apportioning the payment between an amount for damages for injury to feelings and an amount in connection with the termination of employment. The FTT preferred the approach of Mr Oti-Obihara which was "to take a figure which represented the loss arising from the termination of the employment and to argue that that amount … is taxable as an employment termination payment, with the balance being compensation for discrimination and other infringements of rights not relating to financial loss flowing from the termination of the employment.": see paragraphs 43 and 44. The FTT concluded that, on the facts of the case, £165,000 of the £500,000

settlement payment was received by Mr Oti-Obihara in connection with the termination of his employment. The balance was attributable to non-pecuniary loss and not taxable.

38. We cannot agree with the analysis of the FTT in paragraph 31 of *Oti-Obihara* or the approach in paragraph 34. First, it appears that the FTT considered that the decision in *Walker* established that compensation paid on termination of employment where there has also been a claim for discrimination is only taxable to the extent that the payment is compensation for financial loss suffered by reason of the termination. We consider that was a misunderstanding of the ratio of *Walker*. For the reasons given above, we do not consider that the decision in *Walker* is authority for the proposition that a payment on termination must be compensation for financial losses before it can fall within section 401 ITEPA. Secondly, we consider that the FTT in *Oti-Obihara* erred when it asked, in paragraph 31, whether the payment was compensation for the termination of employment. The correct question posed by section 401 is: was the payment received, directly or indirectly, in consideration or in consequence of, or otherwise in connection with, the termination of employment? The existence of a claim for discrimination may be relevant if the discrimination is unconnected with the termination of employment but it does not change the question to be addressed. In our view, the question remains is there the necessary connection between the payment and the termination of employment? The issue does not become whether the payment is compensation for financial loss caused by termination merely because other claims, such as for discrimination, may have been included in the settlement. We consider that, when determining whether a payment received in connection with the termination of employment falls within section 401 ITEPA there is no distinction between non-pecuniary aspects of the award, such as injury to feelings, and pecuniary aspects such as financial loss. In our view, *Oti-Obihara* was wrong on this point and should not be followed.

39. The tax charge in the next case, *A v HMRC* [2015] UKFTT 0189 (TC) (‘*A [2015]*’), did not arise under section 401 ITEPA but under section 62 of that Act. ‘Employment income’ and ‘general earnings’ are charged to tax under Part 2 of ITEPA. Section 7 ITEPA provides that ‘employment income’ and ‘general earnings’ both mean, among other things, ‘earnings’ within Chapter 1 of Part 3. Section 62 is the first section in Chapter 1 of Part 3 and defines ‘earnings’ as follows:

> “(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.”

40. The case of *A [2015]* concerned a race discrimination claim brought by an employee, A, against his employer, a bank. A worked as a trader in the bank from 2003. He believed that, between 2004 and 2007, he was treated less favourably than other employees in relation to salary and annual bonuses because of his race. In November 2007, A wrote to the bank setting out his grievances. At that time, redundancies were imminent because the bank had been acquired by a larger bank. The grievances were investigated but not resolved to A’s satisfaction. In March 2008, A’s solicitor served a questionnaire in relation to race discrimination under the former

statutory procedure. Some two weeks later, the bank told A that he was to be made redundant. The bank offered A statutory redundancy pay of £1,650, an ex-gratia redundancy payment of £48,898 and an additional lump sum of £600,000 in settlement of all outstanding and potential claims. A accepted and signed a settlement agreement.

41. HMRC took the view that the £600,000 payment was taxable as earnings within section 62 ITEPA and amended A's self-assessment tax return for 2008-09. A appealed to the FTT on the ground that the sum was compensation in respect of his threatened race discrimination claim. At paragraphs 59 and 60 of *A [2015]*, the FTT observed that issue was a narrow one of whether the settlement payment of £600,000 compensation to settle a threatened race discrimination claim was taxable as 'earnings' within section 62 ITEPA. The FTT held that it was not.

42. The FTT noted that "HMRC do not make any argument that the payment is in any way 'in connection with' the appellant's termination of employment so as to fall within the provisions of section 401 ITEPA" as HMRC agreed that the payment to A did not fall within the section. It is not clear why HMRC did not seek to argue that section 401 applied in *A [2015]*. It may be because, as the FTT in that case noted at paragraph 60, it was common ground that the £600,000 payment related to alleged discriminatory treatment during the course of A's employment. For that reason, we consider that the decision in *A [2015]* provides little, if any, assistance in determining the issues in this case. We note that the FTT in *A [2015]* did not regard *Walker* or *Oti-Obihara* as relevant to the question of how to interpret section 62.

Case law - section 406

43. The predecessor provision to section 406 ITEPA was section 188(1)(a) ICTA which exempted from tax "any payment made in connection with the termination of … employment by the death of … or made on account of injury to or disability of [the employee]." The leading case on the meaning of section 188 is *Horner v Hasted (Inspector of Taxes)* [1995] STC 766 ('*Horner*') which was an appeal to the High Court from a decision of a Special Commissioner. Mr Horner worked as a tax manager in a firm of chartered accountants and had become obsessed with grievances against the Revenue for their handling of his clients' tax affairs. This had brought about a mental, emotional and physical condition at the time of his retirement, that he claimed amounted to a disability. Mr Horner had not consulted a medical practitioner and provided no evidence at first instance about his condition but asked the Special Commissioner to infer that it amounted to a disability. The Special Commissioner specifically addressed the meaning of 'disability' in section 188 and held that the concept encompassed only something that was a medical condition. The Special Commissioner said, at paragraph 7.18 of her decision, that:

> "I have considered the meaning of the word 'disability' in the context in which it is used. Section 188 exempts payments made in three circumstances, namely death, injury or disability. In my view, within this context, the word 'disability' means a medical condition which disables, or prevents, a person from carrying out his employment in the same way that death or injury are medical conditions which prevent persons from carrying out their employment."

44. The Special Commissioner concluded that the evidence did not justify a finding that, in April 1989, Mr Horner was suffering from a medical condition which disabled or prevented him from carrying out his employment. Accordingly, she found that the

termination payments were not made on account of disability within the meaning of section 188 ICTA and dismissed the appeal.

45. The Special Commissioner's decision was endorsed, on appeal, by Lightman J. At page 800, Lightman J held:

> "It is clear from the language of s 188 that for the exemption to be available it must be established: (1) that the disability alleged by an employee is a relevant disability, that is to say, a total or partial impairment (which may arise from physical, mental or psychological causes) of his ability to perform the functions or duties of his employment; and (2) that the person making the payment does so not merely in connection with the termination of employment (compare the language of the exemption of payment made on the death of an employee) but on account of the disability of the employee. In short, there must be established as an objective fact a relevant disability and as a subjective fact that the disability is the motive for payment by the person making it."

46. Lightman J then held that the Special Commissioner had been entitled to conclude that the evidence did not justify a finding that, in April 1989, Mr Horner was suffering from a medical condition which disabled or prevented him from carrying out the duties or functions of his employment. There does not appear to have been any challenge to the Special Commissioner's view that 'disability' in section 188 means a medical condition or to the reasoning that led to that interpretation. In his judgment, Lightman J seems implicitly to have accepted that death, injury and disability in the section are all medical conditions.

47. The question of the tax treatment of an award for injury to feelings also arose before the Employment Appeal Tribunal ('EAT') in *Orthet*. In *Orthet*, the Employment Tribunal had awarded Mrs Vince-Cain damages of £15,000 for injury to feelings in a sex discrimination case. No mention was made of tax and the parties asked the EAT to determine whether such awards should be taxed. The EAT in *Orthet* held that awards for injury to feelings in discrimination claims, whether arising from termination of employment or otherwise, were not taxable. The EAT gave their reasons at paragraph 33 of the decision:

> "The factors point all in one direction and in our judgment are as follows.
>
> (a) In *Vento v Chief Constable of the West Yorkshire Police* [2003] ICR 318, 330, para 46, the Court of Appeal acknowledged that this was the first time for many years that that court had had the opportunity to consider 'the appropriate level of compensation for injury to feelings in discrimination cases'. Not a word was said about the possibility of the award being taxed. There was no challenge to the principles in *British Transport Commission v Gourley* [1956] AC 185, which is that any award which has a tax implication must be reflected in the final award of damages.
>
> (b) In *Vento v Chief Constable of the West Yorkshire Police* the approach previously adopted in *Prison Service v Johnson* [1997] ICR 275 of consideration of analogies for damages for 'pain and suffering, disability and loss of amenity' in personal injury claims was considered correct. Such an award is not subject to tax.
>
> (c) In *Essa v Laing Ltd* [2004] ICR 746, 760, para 42, Pill LJ said:

> 'while there is a difference between 'injury to health or personal injury' and 'injury to feelings', the two are not inconsistent, may overlap and injury to feelings may contribute to injury to health.'
>
> (d) The assessment of such awards is to be based upon the guidelines of the Judicial Studies Board. Those guidelines say nothing about tax.
>
> (e) The exception in the tax statutes of payments made on account of 'injury to or disability of the employee' is accepted to include mental and physical injury. Injury to feelings, as expressly included in section 66(4) of the Sex Discrimination Act 1975, carries the dictionary definition of 'hurt' and humiliation. Mr Evans argues that injury, wherever it appears, carries with it the same meaning. We agree.
>
> (f) Where the award is in respect to injury to feelings occurring during the course of employment, section 19 of the Income and Corporation Taxes Act 1988 cannot apply, since the award is not made in respect of the employee's acting as employee, and section 148 of that Act cannot apply since the employment continues. See the guidance given to tribunal chairmen, under the heading 'Aims: to consider areas of tribunal work where the impact of income tax may affect the amounts of an award and give guidance to a chairman', promulgated to all chairmen and available to the parties in the instant case. If the award includes injury to feelings as a result of a dismissal, but is not separated from the overall award for injury to feelings occurring during employment, it seems invidious to conduct that exercise.
>
> (g) The advice of the Equal Opportunities Commission, published on its website www.eoc.org.uk, is that an award of this nature is *arguably* not taxable and an award for injury to feelings and an award for injury to feelings per-employment *should not be* taxable.
>
> (h) In at least one appeal to special commissioners, it has been accepted by the revenue that such an award is not taxable: *Walker v Adams* SpC 344 (Mr B M F O'Brien, special commissioner), 15 April 2003, on a reference relating to the taxation of an award by the Fair Employment Tribunal in Northern Ireland, in respect of provisions relating to religious and/or political discrimination."

48. The EAT noted, at paragraph 34, that they had not been referred to any authority on the point. Unfortunately, it thus appears that *Horner* was not cited to the EAT in *Orthet*.

49. The EAT considered sections 401, 403 and 406 ITEPA again in the recent decision of *Timothy James Consulting Ltd v Wilton* [2015] ICR 764 (*'Timothy James'*). The case concerned a claim for unfair constructive dismissal and harassment related to sex. One of the issues on appeal was whether the Employment Tribunal should have grossed up the damages awarded to the claimant to take account of Ms Wilton's liability for income tax. On appeal to the EAT, Singh J considered *Horner*, *Orthet*, *Oti-Obihara* and the decision of the FTT in this appeal. Singh J sought to distinguish *Horner* as follows at paragraph 67:

> "It is important to note that, on its facts, that case did not concern an award of damages for injury to feelings in the context of a discrimination claim. It concerned termination payments that had been made by an employer. Further, the case concerned an issue about the meaning of the word 'disability' and not the word 'injury'."

50. Singh J considered the case law that we have set out above and, having concluded that there were no binding authorities but that there were conflicting decisions in the EAT and FTT, he went on to consider the words of section 406 ITEPA. He analysed the phrase "injury to … an employee" in section 406:

> "84. It will immediately be apparent that that phrase is to be found in paragraph (b) and that that provision is not qualified by the words "in connection with the termination of employment", as the words in the first paragraph are. On the face of it, therefore, it is any injury to an employee which will fall within the exemption.
>
> 85. Secondly, it should be noted that, although the side-note to a statutory provision can be an aid to its construction, it is no more than that. As Lord Reid put it in *R v Schildkamp* [1971] AC 1, at page 10:
>
> > 'a side-note is a poor guide to the scope of a section, for it can do no more than indicate the main subject with which the section deals.'
>
> Although the side-note to section 406 refers to an 'Exception for death or disability payments and benefits', it is clear from the express words of the provision itself that its scope goes wider than that, since the word 'injury' is used as well. The question then becomes what is the correct interpretation of the word 'injury' in this context: is it confined to physical injury, or at least personal injury of the kind that can be the subject of a claim for negligence, or is it capable of including injury to feelings?
>
> 86. Thirdly, it should be recalled that the decision of the High Court in *Horner* was concerned with the interpretation of the word 'disability' and not the word 'injury'. At most what was said in that case about the meaning of the latter word was obiter and not necessary to the decision in that case. In contrast the decision of this Tribunal in *Orthet* was concerned with the meaning of the word 'injury' and addressed in detail the question whether that concept could include the concept of injury to feelings. It should also be recalled that, on its facts, *Horner* was not concerned with an award of damages for injury to feelings, whereas *Orthet* was concerned with that issue and dealt with it at length. Although it is unfortunate that the decision of the High Court in *Horner* was not cited to, nor considered by, this Tribunal, I doubt if it would have led to a different conclusion given that it was not directly concerned with the issue which this Tribunal was addressing."

51. At paragraph 88 of *Timothy James*, Singh J expressly preferred the reasoning in *Orthet* to that of the FTT in this appeal and allowed the employer's appeal.

Discussion - section 401

52. We take the same view of section 401 ITEPA as the Upper Tribunal in *Colquhoun* took in relation to section 148(2) ICTA. We consider that the language of section 401 is clear and its scope is wide. The section, and thus Chapter 3 of Part 6 of ITEPA, applies to payments and other benefits that are received directly or indirectly in consideration or in consequence of, or otherwise in connection with the termination of a person's employment. There is nothing in the terms of section 401, read alone or together with the other sections in Chapter 3, that excludes non-pecuniary awards, such as damages for injury to feelings, from the scope of the section. Section 401 is not restricted to payments made under a contractual entitlement or to payments made at the time of termination. The only question that determines whether section 401 applies is whether the payment was directly or indirectly in consideration or in consequence of, or

otherwise in connection with the termination of a person's employment. We consider that the FTT was correct, in [69], to disregard the possible reasons for the payment, such as the desire to settle Mr Moorthy's claim for unfair dismissal and injury to feelings or protect Jacobs' reputation, as irrelevant. Once it is established on the facts, as the FTT found in [67], that the settlement payment was, directly or indirectly, in consideration or in consequence of, or otherwise in connection with the termination of Mr Moorthy's employment then it is within section 401.

53. We reject Mr Gray-Jones' submission that because the compensation paid to Mr Moorthy was in excess of the maximum amount of compensation that could be awarded for unfair dismissal at the time, the excess must have been unconnected with the termination of Mr Moorthy's employment. It does not follow that, because an amount of compensation exceeds the maximum award for unfair dismissal, the payment is not received directly or indirectly, in consideration or in consequence of, or otherwise in connection with, the termination of employment. Section 401 applies to payments made even where the termination of employment was entirely fair and lawful or where the disability or injury were not the fault of the employer and, similarly, to amounts in excess of the statutory maximum award for unfair dismissal.

54. In our judgment, even damages to reflect non-pecuniary matters fall within section 401 ITEPA if they are connected with the termination of employment (or the other events set out in section 401(1)(b) and (c)). We do not consider that any of the cases relied on by Mr Gray-Jones and the EHRC are authority for drawing a distinction between pecuniary and non-pecuniary loss. Both *Orthet* and *Timothy James* proceeded on the basis that the payments for injury to feelings in those cases fell within section 401. For reasons set out above, we consider that *Oti-Obihara* was wrongly decided on this point and should not be followed.

55. We acknowledge that there is some force in Mr Gray-Jones's submission that there appears to be an anomalous distinction between payments of compensation for discrimination before termination, which in *A [2015]* were held not to be taxable as earnings under section 62 ITEPA, and such compensation paid in connection with termination which, on our view of section 401, counts as earnings. However, in our judgment, that is a consequence of such payment being deemed to be earnings by section 401. It is true that this may require an amount of compensation to be apportioned between events which occurred before and after termination so that they can be treated differently for tax purposes. But we do not consider that such apportionment would be impossible or excessively difficult. The need to carry out such an exercise does not, in our judgment, compel a different construction of the words of section 401, which are clear.

56. Accordingly, we hold that the settlement payment falls within section 401 and, under section 403, counts as employment income of Mr Moorthy for the tax year in which it was received, subject to the £30,000 threshold and to the application of section 406, which we turn to next.

Section 406

57. The two principal cases on which Mr Moorthy relies are the decisions of the EAT in *Orthet* and *Timothy James*. As regards the decision in *Orthet*, as a first point, it seems clear to us that, in paragraphs 33 and 34, the EAT in *Orthet* is discussing whether the award for injury to feelings is taken out of the charge to tax by the provisions of what is now section 406 ITEPA. It is therefore implicit in the decision that the award in

Orthet fell within section 401 as otherwise section 406 would be irrelevant. As an analysis of section 406 and the meaning of "injury", we consider that the EAT's interpretation is flawed and fails to give sufficient weight to the other words of the section as analysed in *Horner*. Our comments on the factors relied on by the EAT for its conclusion are as follows (using the same lettering: see paragraph 47 above):

(a) In our view, it cannot be assumed from the fact that the Court of Appeal in *Vento* did not discuss the tax treatment of awards for injury to feelings that such awards fall within section 406. The tax treatment of such awards does not appear to have been an issue in *Vento*. Similarly, the *Gourley* principle provides no guidance as to the scope of section 406. The principle in *Gourley* simply requires the tax treatment of an award of damages in the hands of the recipient to be taken into account in calculating the amount of the award so that the recipient receives and retains the appropriate amount.

(b) We also consider that the fact that the Court of Appeal in *Vento* considered that damages for injury to feelings were analogous to awards for pain and suffering, disability and loss of amenity in personal injury claims which are not taxable does not provide any support for the view that "injury" in section 406 includes injury to feelings. The Court of Appeal in *Vento* was considering the appropriate level of damages for injury to feelings and not whether they should be taxed or the construction of section 406.

(c) The passage quoted by the EAT from the judgment of Pill LJ in *Essa v Laing Limited* recognises that the concepts of personal injury and injury to feelings are distinct but may overlap. There is no dispute that "injury" in section 406 includes personal injury. We also accept that injury to feelings could be a cause of a relevant injury or disability (eg psychiatric illness). That does not seem to us to indicate that "injury" in section 406 includes injury to feelings but rather that, as Pill LJ said, "injury to feelings may contribute to injury to health".

(d) We do not consider that the fact that guidelines of the Judicial Studies Board (now Judicial College) on assessment of damages said nothing about tax supports the proposition that damages for injury to feelings are not subject to tax or that "injury" in section 406 includes injury to feelings.

(e) We do not accept, as the EAT in *Orthet* appears to have done, that "injury", wherever it appears, carries the same meaning. In our opinion, the meaning of the word "injury" depends on the context in which it occurs.

(f) We do not understand why it is "invidious" for a tribunal to apportion an award of damages for injury to feelings between the amount that was connected with the termination of the employment and the amount that was unrelated to the termination. Such an exercise is not dissimilar to the apportionment made by the FTT in *Oti-Obihara*.

(g) We note that the advice of the Equal Opportunities Commission merely stated that an award for injury to feelings is "arguably not taxable". Such tentative advice does no more than indicate that there is an argument; it does not resolve or, with respect, shed any light on the issue.

(h) As discussed at paragraph [28] above, as HMRC conceded in *Walker* that an amount paid in respect of injury to feelings was not taxable, we do not consider *Walker* provides any support for the proposition that any part of a payment in connection with the termination of employment that is attributable to injury to feelings is not subject to income tax.

58. In conclusion, we consider that the reasons given by the EAT in paragraph 33 of *Orthet* provide very little support for their conclusion that awards for injury to feelings, whether in connection with the termination of employment or otherwise, are not taxable.

59. We have considered carefully, the judgment of Singh J in *Timothy James*. Singh J must have accepted, as the EAT in *Orthet* must also have done, that the amount awarded by the Employment Tribunal fell within section 401 as a payment received directly or indirectly in consideration or in consequence of, or otherwise in connection with the termination of Ms Wilton's employment. If that were not so then Chapter 3 of Part 6, which concerns "Payments and benefits on termination of employment, etc", would not apply and the reference to section 406 would be otiose.

60. It is clear that section 406 is not a general exemption from tax for payments on account of injury to an employee. Rather the purpose of section 406 is to take payments to an employee on account of injury outside of Chapter 3 of Part 6 where they would otherwise, by virtue of section 401, fall within that Chapter because they are payments in connection with the termination of a person's employment. It is because section 406 is only relevant where there is a payment in connection with the termination of employment, that we respectfully disagree with the statement of Singh J in paragraph 84 of *Timothy James* that the phrase "injury to … an employee" in section 406(b) is not qualified by the words "in connection with the termination of employment". Employment will always terminate on the death of an employee, but the employee's injury or disability will not always lead to termination. Injury or disability could also have other consequences that might lead to the provision of payments or other benefits by the employer to the affected employee. Only some of those payments are covered by section 406(b) because only some of them are covered by section 401, namely those payments made in connection with termination of employment or a change in duties or in earnings. Accordingly, we do not consider that section 406(b) can be read as exempting all *payments made by an employer in respect of an* injury to an employee from tax under Chapter 3 of Part 6. In our view, "injury" falls to be considered and interpreted together with "death" and "disability" in section 406 because it has to be something which has led to the termination of employment or to a change in duties or level of earnings.

61. Further, although the interpretation of sections 401 and 406 in this case arises in the context of determining the tax consequences of an award of damages for wrongful or unfair conduct, those sections are not only applicable where the payment is made as a result of some unlawful conduct by an employer. If a person is killed or suffers injury or disability in a road accident, that might make him unfit for work and may trigger payments in relation to a change of duties or earnings. That is the case even where the accident was entirely unconnected with any fault of the employer. Sections 401 and 403 do not draw a distinction between payments arising from the infringement by the employer of the recipient's rights and other payments.

62. We agree with the comments of Singh J, in paragraph 85 of *Timothy James*, about the use of side-notes as aids to construction. However, while side-notes may be poor guides to the scope of the section, such guidance as the side-note to section 406 ITEPA offers points to the section being concerned with payments or other benefits for medical conditions such as death or disability. In our view, the side-note supports the interpretation of the word "injury" in section 406 as meaning a medical condition that results in the termination of employment or a change in duties or earnings related to the employment. On that interpretation, injury to feelings would not come within section 406. Accordingly, while we agree with Singh J, at [86] of *Timothy James*, that what was said in *Horner* about the meaning of "injury" in section 188 ICTA was strictly obiter because the case concerned the meaning of "disability", we consider that the reasoning of the Special Commissioner in that case still holds good.

63. Accordingly, we decline to follow *Orthet* and *Timothy James*, because we consider them to be wrongly decided in so far as they held that "injury" in section 406 ITEPA includes injury to feelings. The only other decision to have considered the scope of a precursor to section 406 is *Horner*. In *Horner*, Lightman J accepted the Special Commissioner's view that "death", "injury" and "disability" in section 188 all refer to medical conditions. Following *Horner*, which we prefer to *Orthet* and *Timothy James*, we consider that "injury" in section 406 refers to a medical condition and does not include injury to feelings.

Effect of HMRC's concession

64. We can deal with this issue quite briefly because of the way it was put by Mr Gray-Jones and our conclusions so far. The FTT concluded that the concession made by HMRC that £30,000 of the payment was not chargeable to tax had no statutory basis and they had no jurisdiction in respect of the 'concession'. Mr Gray-Jones stated that it is clear from the reference to the *Vento* maximum that HMRC only intended the concession to relate to an award for injury to feelings in the age discrimination complaint rather than the age discrimination claim as a whole. He submitted that if injury to feelings awards are not taxable then the concession was correctly made and within HMRC's general care and management powers. On that basis, the FTT were wrong to disregard it. Mr Gray-Jones's alternative submission was that the concession created a legitimate expectation that it would not be disregarded.

65. We have already decided that the settlement payment falls within section 401 and "injury" in section 406 does not include injury to feelings. The foundation of Mr Gray-Jones's primary submission is thus fatally undermined. Further, even if HMRC have the power to waive or forego tax which is properly due, that is not what happened in this case. HMRC did not give a ruling that the part of the settlement payment attributable to injury to feelings was not chargeable to tax. Such a ruling might have been capable of creating a legitimate expectation (see *R v IRC, ex p MFK Underwriting Agencies Ltd* [1989] STC 873). In this case, however, the closure notice clearly stated that the offer to treat the further £30,000 as not taxable was a concession made in order to try to reach agreement. Mr Moorthy did not accept the offer and appealed to the FTT. As agreement was not reached, the condition on which the offer was made was not met and HMRC's offer fell away. It follows that the concession was not rightly made on a correct view of the law and the FTT were right to disregard it. The alternative submission fails for the same reason as, leaving aside the question of jurisdiction, Mr Moorthy could not have had a legitimate expectation that the FTT would not apply the law as they interpreted it.

Disposition

66. For the reasons given above, Mr Moorthy's appeal is dismissed.

Costs

67. Any application for costs in relation to this appeal must be made within one month after the date of release of this decision. As any order in respect of costs will be for a detailed assessment, the party making an application for such an order need not provide a schedule of costs claimed with the application as required by rule 10(5)(b) of the UT Rules.

The Hon Mrs Justice Rose DBE
Chamber President

Greg Sinfield
Judge of the Upper Tribunal

Release date: 14 January 2016