TC04381

Appeal number: Withheld

INCOME TAX – Employment income – whether payment made pursuant to a compromise agreement by employer to its employee taxable as "earnings" under s62 ITEPA – no- payment non-taxable as it was made in respect of potential race discrimination claim – appeal against HMRC's amendment to appellant's self-assessment allowed in principle

Careless inaccuracy penalty – taxable redundancy amounts not included on return – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Mr A **Appellant**

- and -

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

TRIBUNAL: JUDGE SWAMI RAGHAVAN
SANDI O'NEILL

Sitting in public at 45 Bedford Square, London on 30 May 2014 and 28 August 2014

Michael Firth, counsel for the Appellant

Maurice Chapman, HMRC Officer, for the Respondents

DECISION

Introduction

1. The appellant worked as a trader for a European bank ("the Bank") in London for a number of years. The primary issue in this appeal concerns the tax treatment of a £600,000 payment he received from the Bank before leaving it and whether the payment is chargeable to tax on earnings from employment because it was designed to make good shortfalls in salary and bonus, as HMRC argue or, whether the sum was compensation in respect of the appellant's threatened race discrimination claim, as the appellant argues.

2. HMRC amended the appellant's 2008-9 tax return to reflect their view that the payment was taxable as earnings but the appellant also argues that even if the sum was earnings then HMRC should, consistent with their view that payment was for past bonuses, have assessed for those earlier years and that the amendment for 2008-9 was incorrect.

3. The appellant also appeals against a Schedule 24 Finance Act 2007 careless inaccuracy penalty in the amount of £739.72 for failing to include the redundancy element of the payments he received on his 2008-9 tax return. He argues that he is not liable as he took reasonable care in completing the form.

Anonymisation

4. The appellant made an application for the decision to be anonymised, to which HMRC did not object. This was on the basis that the Tribunal would need to consider various issues relating to the conduct of the appellant's employer which was alleged to be racially discriminatory in considering the appellant's case but that it would be unfair for the employer to be exposed in this way when it did not have an opportunity to answer those allegations. The appellant referred us to *(Redundant Employee v McNally (Inspector of Taxes)* [2005] STC (SCD) 143) where it was directed by the Special Commissioner that the hearing should be in private on similar grounds. While we were invited by the appellant to anonymise the decision under Rule 32 of the Tribunal's Rules, we noted the non-disclosure provision set out at Rule 32(6) of these Rules only arises where a hearing has been held wholly or partly in private. Although as it turned out, no-one apart from the parties and their representatives and HMRC's witness was present at the hearing it was a hearing which was held in public and so the decision cannot be anonymised pursuant to Rule 32. We noted however that it would be possible to anonymise this decision using the Tribunal's general case management power in Rule 5 of the Tribunal's Rules. For the reasons related to fairness which the appellant mentioned we were satisfied that the decision should not disclose information which would enable the identification of the appellant's employer. We queried with the appellant what the basis was for extending the anonymisation to the appellant given the reason underlying the request was protection of the identity of the employer. We accepted the appellant's argument that in order to preserve the employer's anonymity details relating to the appellant's name and nationality ought also to be anonymised as otherwise it would be possible for anyone

employed in the specialised sector which the appellant worked in to deduce the identity of the employer.

Roles of various employees at the Bank referred to in this decision

5. In setting out the factual background it is necessary to refer to a number of different employees of the Bank. It is helpful to state at the outset the roles of the relevant individuals and the abbreviations by which we refer to them:

(1) **The appellant** – Managing Director within Emerging Market's ("EM") Group

(2) **B** – member of the Bank's Executive Committee and in charge of EM Group.

(3) **C** – Deputy in charge of EM Group.

(4) **Chairman** – the chairman of the Bank's board.

(5) **D** – Executive board member and head of EM Group who took over from C in 2006.

(6) **E** – the Managing Director who initially dealt with the appellant's official grievance.

(7) **F** – Senior Director of Human Resources who as well as being in post at the time of the Bank's settlement discussions with the appellant was the person at the Bank who responded to HMRC's subsequent enquiries to the Bank on the background to the settlement payment.

Evidence and Facts

6. We heard oral evidence which was subject to cross-examination from the appellant and, on behalf of HMRC, Mrs Catherine Spalding, who was an HMRC Higher Officer who had handled the appellant's case and spoke to the various communications HMRC had with the Bank in relation to the matter. Both witnesses assisted the Tribunal with its further questions and we found both of them to be credible. Based on the evidence we heard and the documents before us we were able to make the following findings of fact.

7. Prior to joining the Bank the appellant had worked for 14 years for three other banks in the City. He started working at the Bank as a trader in April 2003. His job title was Managing Director. He was recruited to head up the Local Currency Debt Book within the newly formed Emerging Markets ("EM") Group. His Service Agreement provided for a basic salary of £120,000 and stated that he was also eligible for the Bank's bonus scheme. Clause 5.2 of the Service agreement described the bonus scheme as follows:

> "The scheme is discretionary giving no automatic entitlement to an particular level of payment. However the [Bank] will primarily take into account the extent to which the Officer has achieved his personal sales and business development goals when considering the appropriate award."

8. The person whose idea it was to set up the EM Group, B, did not share the European nationality of those who comprised the Executive Committee (which was made up of one nationality). That person's "second-in-command", C, shared the same non-European nationality as the appellant.

9. There were seven or so others at Managing Director (MD) level who were responsible for different areas such as infrastructure or securitisation. The Emerging Markets team was a small one of five or six members.

10. In February 2004 the appellant received a bonus of €50,000. He regarded this as a very small bonus given he had made a profit of €3 million in the six months or so of trading in 2003. The Bank told him that as he had just started he could not expect a substantial bonus but that from then on he would be awarded good bonuses if he performed equally as well.

11. In February 2005 the appellant was awarded a bonus of €125,000. He challenged this as he had made a profit of €9.1 million. He told the Bank that he wanted to leave because his contribution was not being recognised whereas other Managing Directors were getting substantially higher bonuses than he was.

12. Bonuses were decided by the Chairman and were notified by letter. B and C intervened on the appellant's behalf and his bonus was increased to €725,000. He was told not to mention this to anyone else and that in future "he would be rewarded properly without any debating from then on".

13. In the course of 2004, B fell out with the Chairman and left in early 2005. The appellant says B received an out of court settlement for his mistreatment by the Bank. In December 2005 C was dismissed. The appellant says C took legal action and the appellant says this was settled in C's favour. The appellant's view is that there was a plan to get rid of C as soon as B had gone. The appellant believed that it was at B's insistence that he had been hired by the Bank in the first place.

14. The appellant's evidence is that although he was the most senior emerging markets trader at the Bank at the time he was not invited to apply for C's role. It went instead to D who had joined the Bank a few months earlier and as far as the appellant knew did not have knowledge of emerging markets trading. The appellant also had to report to and pass his trades through a more junior colleague. He felt sidelined and was not from then on invited to investment meetings, client briefings or formal client events.

15. In calendar year 2005 the appellant made a profit of €7.7million for the Bank and was paid an approximate bonus in February 2006 of €75,000. He complained and was told it was a matter for the Chairman to decide. He saw the Chairman in May 2006 and says the Chairman told him that he should receive in 2006 a bonus of 10% of the monies made for the Bank. The Chairman said D would sort out the details. The appellant then met with D and he said he was told by D that D would make up for the low bonus which had been awarded in 2006 (for calendar year 2005) and that he

would also get 10% of the monies for calendar year 2006 (to be paid in February 2007).

16. In February 2007 the appellant received a bonus of €125,000 having made a profit of €3.6 million in calendar year 2006.

17. The appellant asked D about his promise of receiving 10% of profits made for the Bank. At first D maintained he could not remember this and then he said that the Chairman had stated the appellant was to be awarded €175,000. The appellant pointed out that his bonus award letter referred only to €125,000 and that in any case 10% of the profits should have been €360,000. D agreed to look into the matter.

18. From a chain of e-mails between the appellant and D dated 13 February 2007 we can see that the appellant was chasing D to sort out the bonus issue before D went on holiday. In the appellant's e mail he reports D as saying in June 2006 "I can't do anything about this year but I will make it up to you next year" and "I can't give you a written contract you have my word I will give you 10% of what you make as your bonus: [the Chairman] has agreed to this and we want you to stay and do well". D replied saying "I hear you. I am a man of my word. What I need is confirmation of your actual numbers and then a conversation with [the Chairman]". D stated that it was difficult to get a face to face meeting with [the Chairman] due to meetings with investors and foreign travel. D's e-mail then asked "…in the meantime, who is best placed to get an accurate assessment of your P&L…?" The appellant then sent an exasperated e-mail setting out details of how his trades could be verified.

19. The appellant said he kept getting fobbed off when he pursued the discrepancy. He said that by early spring 2007 he had been notified about trading activities he could no longer do and that his credit lines were being reduced. He was told this was because of the Bank having to reduce risk because of a sale of the Bank to a larger bank.

20. The appellant's evidence was that this was a made up story as other traders were being given extra credit lines. He found out his book was being handed to one of D's close friends when that person had started to ask the appellant questions about the instruments the appellant was supposed to be trading.

21. The appellant was asked in cross-examination how he knew what level of bonuses others were getting. The appellant told us there were certain employees for example those on the board whose remuneration was disclosed in shareholder information although the Tribunal was not given any audited accounts to show the levels of salary and bonuses awarded. While he did not know the exact amounts that had been awarded to other employees he overheard conversations in the cafeteria which gave him a rough idea of what they had received or that they had been "well looked after".

22. The appellant told us that salary increases at MD and Vice President level were communicated on a one to one basis. He knew that one of his colleagues got an increase because that colleague had asked him "Did you get an increase too?".

23. Although HMRC query how the appellant could have known of others' bonuses and salary we find the appellant's explanation that he had a rough idea of others' bonuses perfectly plausible. The UK office of the Bank was a relatively small operation and we can imagine, given the large sums involved and the significance of those sums to the Bank employees' overall remuneration, that inevitably employees would make allusions as to the rough size of their bonus awards and word of this would spread even if the precise amounts were not known.

24. The appellant's evidence set out details of two incidents of remarks made to him which he acknowledges were petty and said in a seemingly jokey context but which we can see might have led to a feeling he was being looked down upon in a way which referenced his ethnicity or nationality. The first was by the Chairman implying that the reason why the appellant had not received an expensive set of branded luggage which had been given to all the other MDs was that because he would not know what to do with such an expensive product. The second remark was made by the vice-chairman suggesting that the appellant wore the same clothes and querying whether this was "normal in [non-European country] or where ever you come from?".

25. The Bank was bought out and the deal finalised in the latter part of 2007. The appellant was notified of imminent redundancies. At this point he decided it was time to take "proper action" with the help of an employment solicitor. His previous grievances about his treatment had been "verbal".

26. He told his lawyer about the various issues he had and showed him the employer handbook. He was advised by his lawyer to go through the disciplinary process first.

27. On 14 November 2007 the appellant met with the Bank.

28. On 28 November 2007 he wrote to the Bank setting out his grievances. The letter was drafted with the assistance of the appellant's lawyer. Its content reflected what the appellant had told his lawyer but with, as the appellant put it, the lawyer's "legal phrasing". From the contents of the letter it can be inferred that this letter was addressed to D. These were grievances concerning "1. My apparent selection for redundancy by the Bank 2. My unfair treatment by the Bank in connection with my pay and bonuses". His letter then went through each of the years setting out the facts upon which he relied.

29. Given the importance placed in relation to the later correspondence from the Bank it is worth setting out in more detail what the appellant said about the 2005 bonus. He said that after complaining and chasing he saw the Chairman in May 2006 who told him that he should receive in 2006 a bonus of 10% of monies that he had made for the Bank. He said he was told that the Chairman would not commit this in writing but would leave the detail to the new executive director (who was D). He said that he, the appellant, had then met with D and that D had confirmed he would make up for the low bonus awarded in February 2006 and would also give the appellant 10% of monies made for the Bank in 2006 (paid February 2007). The letter also says "You D said that with you now in charge there will be no discrimination as before when bonuses are decided and that who ever performs will be rewarded accordingly and

who ever doesn't wont (sic) be paid just because they know the right people." He goes on in relation to the bonus for 2006 to refer to the e-mails he had written above to D in 2007.

30. Under the heading "Non-payment of bonus" he stated "I believe I have been underpaid the bonus that I am entitled to expect from the wording of my contract and from the companies (sic) dealings with me". The appellant stated that the additional bonus payments due to him were €695k for calendar year 2005 and €225k for 2006. He also complained that he had never had a pay rise even though other Managing Directors had within the last four and half years. The letter concluded:

> "Contractually, my Contract provides that my bonus should reflect my personal performance but, clearly, this has not occurred. Nor have the promises that have been made to me by the Bank been kept. I consider the Bank to be in breach of Contract with me and have subjected me to unlawful discrimination on grounds of my racial or ethnic origin."

31. On 11 December 2007, the appellant is reported, in E's letter of 6 March 2008, as having met with E, the director who initially dealt with his grievance.

32. On 29 February 2008 he raised a further grievance relating to the bonus award for 2007. He wrote to E saying he was unhappy that three months had passed and his grievance remained unresolved and expressing concern that while others had been notified of the bonuses they would receive for 2007 a couple or so weeks ago he had received no notification of any bonus that would be awarded to him. Also he stated that he was aware that even employees who sustained losses for the bank in 2007 received bonuses yet he received none. He maintained that it was his belief that it was because of his ethnic origin that he had received less favourable treatment.

33. On 4 March 2008 the appellant is reported as having met with E in E's letter of 6 March 2008.

34. On 6 March 2008 the Bank responded in the form of a letter from E. The letter refers to discussions having taken place with F to see if the grievance could be resolved informally and that the formal grievance process had been suspended meanwhile. The letter explained that the selection for redundancy was not perverse as the appellant had claimed but that the particular country fund the appellant had co-managed had closed in 2007 and that the Bank had reduced its appetite for emerging market risk and trading and his role had disappeared. On salary it was said that increases were at the discretion of the Bank and that:

> "A significant proportion of MDs did not receive salary increases in the years in question. Therefore I do not find that the fact that you did not receive an increase in the years in question was out of line with the treatment of many of your peers."

35. In relation to bonuses the letter commented as follows:

(1) For 2005 E was quite satisfied that it was dealt with in the summer of 2006 by D agreeing a future bonus from 2006 of 10% net profit. The letter

mentions that at a meeting on 4 March the appellant had raised for the first time that he had been promised by C at a meeting with other MDs in early 2005 a potential bonus of 10% for 2005 and that the appellant had informed D of this commitment. E says he investigated this further and that D's response supported none of this in that D said the appellant had said nothing to D about a meeting with C in which C promised to pay the appellant a bonus of 10% for 2005. Rather the 10% was said to be an idea D had offered to the appellant and that D had made it clear he could not agree to adjust the 2005 bonus which stood but that he proposed 10% of net attributable revenue going forward. E concludes that the bonus for 2005 was raised in 2006 with D and not adjusted but a 10% bonus was indicated for the future and the 2005 bonus question was closed.

(2) For 2006 E noted that the trading results from a particular country fund had not been taken account of. It was reported that the appellant's claim that a 50/50 arrangement had been agreed with another employee had been confirmed with that other employee and that the bonus should therefore include a credit for 50% of profit from that fund. E also says he investigated the accounting results with London and the offshore centre where account records were also kept and that as a result the appellant's net revenue contribution for 2006 should amount to an additional sum of €209,339 over the €125,000 the appellant was paid. E said he would instruct the Bank to credit the appellant accordingly and that he could only conclude that it was an error that the appellant was not paid this sum in February 2007.

(3) In relation to 2007 the letter states the appellant had no net revenue contribution and concluded the appellant was not entitled to any bonus.

36. As for the appellant's allegation that he had received less favourable treatment in terms of compensation (salary and bonuses) as a result of his ethnic origin the letter stated: "in my investigation I have found no evidence of less favourable treatment of you let alone on the grounds of your ethnic origin." The letter informed the appellant he could appeal by writing to another officer within seven days which the appellant duly did on 12 March 2008.

37. In a letter of that date he disputed E's depiction of the facts as to his role disappearing. In relation to salary he states his belief that other staff received salary increases and that this was directly referable to matters other than his work performance. According to the appellant the lack of salary increase was due to discriminatory treatment of him. In particular he maintained that his ethnic origin was held against him because a previous Executive Director of the same origin was dismissed in 2005.

38. On the bonus awards the appellant maintained that E had not properly dealt with the various points. He said the 2005 bonus was first discussed with the Chairman in May 2006 and it was he who had agreed a bonus of 10% of monies made for the Bank in 2006 and that "similarly under payment of bonus in 2005 would be corrected". The appellant also maintained that the reason given for not putting the payment through in

2006 was because of "accounting and internal company procedures" which meant it was easier to put the adjusted payment through in February 2007.

39. In relation to 2005 the appellant stated: "I do not consider that the situation in 2005 is closed, because it was due to unlawful discrimination against me on the grounds of my ethnic origin."

40. In relation to 2006 the appellant's issue was that he had been denied the monies for over a year and also that, had he been given the bonus as he said was normal in part shares as well as money, he could have realised the shares at a profit. He went on to say: "Thus the action taken by E to purport to correct the unlawful discrimination of which I was subjected in my 2006 bonus is a wholly unacceptable method of dealing with my grievance." He disagreed that the matter was an error. He referred to an e-mail being sent in December 2006 to D with a detailed breakdown of the profit he made including the country fund. He also challenged the level of the figure because even if that fund had not been taken into account the bonus should have been €200,000 given the profit was €2 million. He claimed there had never been any intention to pay 10% for 2006.

41. In relation to 2007 the appellant said that he did not claim a 10% bonus but highlights that he "maintained a risk free trading book with miniscule losses (€121,000)" while others who had accumulated "large losing positions" had gone on to receive bonuses.

42. Under the heading "Racial Discrimination" he reiterated that he had been subjected to less favourable treatment on grounds of ethnic origin. He also pointed out that he had been provided with no information as to the nature of the investigations carried out, or the material upon which E rejected his claim of discrimination. He ends by saying "In the circumstances, I must reserve the right to pursue this further. I intend to do this separately from my grievance appeal."

43. On 11 March 2008 the appellant had a meeting with the Bank in relation to the proposed redundancy of his role. The Bank wrote him a follow-up letter (we did not see a copy of this.)

44. On 19 March 2008 the appellant's solicitor served a questionnaire under s65 Race Relations Act 1976. This was addressed to the company secretary of the Bank (who was in the same office building as the other London personnel.) The questionnaire set out a summary of why the appellant maintained he had been treated unlawfully and specified the name of a less experienced English trader who had joined later but who had been retained as an employee. It included the claim that the appellant had been treated less favourably in relation to salary and bonuses and that this had been continuing since 2005 when the person with the same ethnic origin as the appellant had been dismissed. He stated "The only logical inference that can be drawn from my treatment by the Bank over the last 2-3 years is that I have been the victim of continuous race discrimination". The questionnaire gave the Bank the opportunity to state whether it accepted this or if not to explain why not and the reasons for the treatment accorded to the appellant. There were extensive questions about bonus

determination and criteria and the details of the bonuses awarded to employees broken down by job title, ethnicity, duration of employment and specific requests for information in relation to the named trader. There were also questions relating to the decision to consider the appellant for redundancy and a request for details of the number of employees who had their employment terminated. The questionnaire ended with the following note:

> "N.B – By virtue of section 65 of the Act this questionnaire and any reply are (subject to the provisions of the section) admissible in proceedings under the Act and a court or tribunal may draw any such inference as is just and equitable from a failure without reasonable excuse to reply within a reasonable period, or from an evasive or equivocal reply, including an inference that the person questioned has discriminated unlawfully."

45. On 26 March 2008 the Bank informed the appellant he was being made redundant and offered him £1,650 in statutory redundancy pay and an ex-gratia payment of £48,898. This letter refers back to the meeting the appellant had with the Bank on 11 March 2008 in relation to the proposed redundancy of the appellant and the Bank's follow up letter to the appellant of the same date. We infer from the absence of any reference to the discrimination questionnaire sent to the Company Secretary that on the balance of probabilities the letter of 26 March 2008 which was from an HR official of the Bank was written without knowledge of the fact the discrimination questionnaire had been sent.

46. A couple of days later the Bank offered the appellant an additional lump sum if he signed a Compromise Agreement.

47. On 9 April 2008 the appellant signed the Compromise Agreement. At clause 2 the agreement records the basis of the agreement as being as follows:

> "The parties have entered into this Agreement to record and implement the terms on which they have agreed to settle all outstanding claims which the Employee has or may have against the Employer…arising out of or in connection with or as a consequence of his employment and/or its termination. The terms…are without any admission of liability on the part of the Employer…"

48. Clause 9.1 specifies the following sums to be paid to the appellant. A statutory redundancy payment of £1,650, an ex-gratia redundancy payment of £48,898 and the sum of £600,000.

49. Clause 16 is headed "Full and final settlement". Clause 16.1 goes on to state that:

> "This Agreement has effect for the purpose of compromising without any admission of liability on the part of the Employer…by means of full and final settlement all claims in all jurisdictions under contract, tort, statute or otherwise which the Employee has at the date of this Agreement or which may arise in future and whether known or not against the Employer…arising out of or in connection with or as a consequence of his employment and/or its termination including in

> particular for the avoidance of doubt the following claims which the employee has raised or intimated…"

50. The clause then as part of this non-exhaustive list sets out 16 various references to various claims. These include "damages for breach of contract howsoever arising…" and at 16.1.6 "discrimination" under the various pieces of UK discrimination and equality legislation including the Race Relations Act 1976."

HMRC's subsequent enquiries and the employer's responses

51. With the authority of the appellant HMRC wrote to the Bank to ask for a detailed breakdown of what the £600,000 payment consisted of and for copies of documents between the Bank, the appellant and the appellant's lawyer in relation to that. The reply came from F who explained the settlement dealt with "any and all claims relating to his employment and termination thereof." It was a total settlement negotiated first as €700,000 and then converted to sterling and rounded down to £600,000. The letter sets out the background to the process dealing with the appellant's grievance and that it was admitted there was an error in the bonus for 2006 (£178,922) which was "not paid immediately, but was taken into consideration in the settlement negotiations." The letter outlined difficulties in dealing with the appellant's grievance as senior executives including those involved in employment and remuneration decisions over the past few years were leaving the bank. The settlement was finalised without any allocation of specific amounts to specific parts of his claims. It was said in summary:

> "…that the Bank decided that his claims held certain merit and the Bank also had issues with dealing with the grievances, and any potential proceedings in terms of witnesses".

52. HMRC's further request of 18 May 2011 asked F to explain what elements of the claim the Bank considered to have merit and were capable of successful litigation. It also asked whether the Bank believed that the appellant had any contractual entitlement to the £600,000 compensation payment.

53. F of the Bank replied accordingly on 20 June 2011 with a more detailed response. He set out details of the error for 2006 bonus again and described the other elements of the appellant's claim as "for 2007 Bonus (EUR 150,000), 2005 Bonus (EUR 620,000) with interest (EUR 60,000) and relating to lack of salary increases (EUR 50,000)". The letter stated:

> "[The appellant] alleged that, in the absence of other explanations, his treatment had been motivated by racial discrimination. After investigation we found no evidence that this was the case and, instead, attribute poor communication and management failings to the situation that led to the claims and negotiated settlement.
>
> Whilst there was a risk, under litigation, that he may have been successful, in whole or in part, with his claims for any or all of the above elements, it was the 2005 Bonus element which caused us most concern to defend under litigation and made up the lion's share of his claims."

54. The letter went on to say:

> "The reasons for this assessment are that it appeared plausible that the bonus he received for 2005 (EUR 75,000) was very low compared to the profits he generated. Further it appeared plausible, as he claimed, that verbal assurances may have been given to him that he may have expected to receive around EUR 770,000 rather than the EUR 75,000 he actually received."

55. The letter continued:

> "There was some evidence that during 2006 [the appellant] had disputed the lower payment made to him, and represented that he should have received a far higher amount. This matter was not resolved when we entered these negotiations at the time of the termination of his employment. As said we identified litigation difficulties as the senior managers who purportedly had discussions with him about his 2005 bonus had all left and in our opinion would not be effective or indeed co-operative witnesses in case of litigation. More likely, in our opinion, [the appellant] may have been able to produce one or more corroborating witnesses. We also had to bear in mind potential High Court costs, which could have easily exceeded £150,000. In summary it was the 2005 bonus claim…"

56. The letter concluded by saying:

> "It is difficult to give definitive answers as this was a negotiated settlement to settle all possible claims, without specific apportionment…we believe we negotiated the lowest possible "global settlement" number that was also acceptable to [the appellant]".

57. No further enquiries were made of the Bank by HMRC and HMRC did not pursue the Bank's admission there had been "poor communication and management failings" any further.

Law

58. Section 62 of The Income (Tax Earnings and Pensions) Act 2003 ("ITEPA 2003") deals with "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."

59. Section 401 ITEPA deals with payments or other benefits received in connection with the termination of a person's employment. It is not directly on point in this appeal as HMRC agree the payment does not fall within this section. But as this

section is useful for understanding some of the case-law we were referred to we set it out:

> "Section 401
>
> (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-
>
> the termination of a person's employment…."

Discussion

60. As noted above the issue before us is the narrow one of whether the settlement payment of £600,000 falls to be taxed as "earnings" within the meaning of s62 ITEPA as 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 s401 ITEPA. In relation to the appellant's argument that the payment was for discrimination, while HMRC do not accept that the appellant was treated differently, it is not in dispute between the parties that the alleged discriminatory treatment relevant to this appeal relates solely to the appellant's treatment during the course of his employment.

61. The reference to "emolument of the employment" in s62(1)(c) and the fact that ITEPA was a piece of tax simplification legislation intended not to introduce substantive changes to the law indicate that previous case-law on what was captured as "emoluments from employment" is still relevant in considering what are "earnings" under ITEPA[1]. The appellant accordingly correctly articulates the test of what counts as earnings from statements made by the House of Lords in *Hochstrasser v Mayes* 38 TC 673 and *Shilton v Wilmhurst* 64 TC 78. According to these cases the test is whether a payment is a reward for services past, present or future.

62. In *Shilton* Lord Templeman states:

> "…If an emolument is not paid as a reward for past services or as an inducement to enter into employment and provide future services but is paid for some other reason, then the emolument is not received "from the employment""

Are awards of compensation for race discrimination calculated by reference to loss of earnings taxable under s62 ITEPA?

63. The appellant's case is that the Bank made the payment of £600,000 in settlement of a claim for race discrimination and that the sum represented compensation for the appellant's unfair treatment in receiving low or no bonuses over several years and no salary increases. If the appellant had taken his case to an employment tribunal that tribunal would be able to award damages for race discrimination which took account of the under payments of salary and bonus arising from the discrimination. Employment tribunals may also award damages for injury to feelings arising from

[1]See Simon's Tax Cases E4.101 and E4.401

discrimination. Referring to the House of Lords decision in *Deeny v Gooda* which we discuss below the appellant's view is that such damages which relate to an employment pre-termination are not taxed under s62 ITEPA. The appellant argues, and HMRC made no argument against this, that as a matter of principle a sum paid to settle a claim should be treated in the same way as a sum paid as a result of the judgment of the court or tribunal on the claim for tax purposes.

64. HMRC dispute that on the facts of this case race discrimination was the reason why the Bank made the payment. But in any case they point to cases where damages calculated by reference to earnings have been treated as taxable and argue that where damages for discrimination are awarded by reference to earnings (whether pre- or post termination of employment) then the amount relating to earnings is taxed under s62 and s401 respectively.

65. In *Deeny v Gooda Walker Ltd* [1996] STC 299 the issue before the House of Lords (as summarised by Lord Hoffman at the start of his speech) was "whether damages awarded to a member of Lloyd's in compensation for losses caused by the negligent conduct of the underwriting on his behalf are a taxable receipt of his underwriting business". The appellant referred us to the following passage of Lord Hoffman's judgment :

> "The fact that damages are computed by reference to income which would have been earned does not mean that they are compensation for the loss of that income…It is accepted, for example, that damages for personal injury are compensation for the personal injury, though partly calculated by reference to the income which the injured person would have earned (see *British Transport Commission v Gourley* [1956] AC 185). In *Lewis v Daily Telegraph Ltd* [1964] AC 234 it was decided that damages awarded to a company for libel are compensation for damage to its reputation, even though calculated in part by reference to the loss of profits which the libel has caused. In both cases, therefore, the damages were not taxable because they were not compensation for a revenue receipt."

66. HMRC question whether the statement referred to in *Deeny* may be extended to facts beyond those of that case which related to insurance losses whereas the appellant says the above statement clearly speaks to a general principle.

67. We agree the above statement was clearly intended to make a broader point. But we note first that the statement was obiter (the statement was part of Lord Hoffman's observations on an argument that a legal right to compensation for the loss of a trade receipt gave rise to a payment which by definition arose out of the trade and he made this point having already been satisfied the appeal was to be dismissed) and second that the remainder of their Lordships did not endorse Lord Hoffman's views on the obiter point. In any case at best the statement only assists the appellant to the extent that it supports the view that a reference to loss of income in the way damages are calculated does not necessarily mean the damages compensate loss of income. It does not go as far as saying that damages calculated by reference to loss of income could never be viewed as being compensation for loss of income.

68. HMRC's case was that there was a distinction to be drawn between payments for discrimination by which we understood it to be meant that the sum for injury to feelings was not taxable but that the sum calculated by reference to loss of earnings was taxable. HMRC referred us to *Walker v Adams* [2003] STC (SCD) 269 which was a decision of the Special Commissioner in support of this.

69. In *Walker v Adams* the appellant left his employer in circumstances which amounted to a constructive dismissal for religious discrimination. He was awarded compensation by the Fair Employment Tribunal which consisted of an amount for injury to feelings and in respect of net income loss both to the date of the decision and in the future, and in respect of loss of pension rights. HMRC withdrew its claim to tax the award in respect of injury to feelings so that point was not before the Tribunal. The Tribunal's decision was that the balance of the award which included compensation for loss of earnings was taxable.

70. While acknowledging, as pointed out by the appellant, that this case considered the predecessor provisions (s148 ICTA 1988) of s401 ITEPA which has different wording to s62 Mr Chapman, for HMRC, submitted the principle – compensation for loss of earnings was taxable - was the same.

71. HMRC also referred to the First-tier Tribunal decision of *Oti-Obahara* [2010] UKFTT 568 (TC). In that case the appellant, who had brought proceedings for race discrimination against his employer, negotiated a settlement in which he waived all legal claims he might have against his employer and received a settlement sum.

72. HMRC referred to the fact that in *Oti-Obahara* the Tribunal calculated a figure apportioned to compensation for financial loss resulting from the termination of the appellant's employment by reason of discrimination suffered. This amount was subjected to tax. Mr Chapman argued that "where earnings were involved" these were taxable in some shape or another.

73. We can see no support either in principle or authority for Mr Chapman's argument in relation to s62 ITEPA which is the provision with which we are concerned. There is no authority which supports his view that damages payments which are calculated by reference to loss of earnings are taxable under s62 ITEPA because "earnings are involved". *Walker v Adams* was exclusively concerned with whether the payment fell within the tax provisions on termination payments. Those provisions are widely drawn. They are certainly wider in scope than s62 in that the fact that a type of payment is caught under s401 through a connection to termination does not mean a payment of a similar type (but with no connection to termination) would be caught by s62. Similarly the fact that the Tribunal in *Oti-Obihara* considered that compensation for financial loss arising out of termination for discrimination was taxable under s401 does not mean such compensation would be caught by s62.

74. However it must be acknowledged that the appellant's view that such damages are not captured by "earnings" is equally bereft of authority. None of the decisions we were referred to deal in an authoritative or even persuasive way with the point of

whether compensation in respect of underpaid salary and bonus due to discrimination is subject to tax under s62 ITEPA or its legislative predecessors.

75. In *Oti-Obihara* the view was expressed at [31] after considering financial loss compensation arising out of termination that :

> "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".

76. But this point was clearly only relevant to the Tribunal's views on s401 ITEPA. At [49] the Tribunal noted that HMRC in that case did not contend that any part of the settlement payment should be taxed as employment earnings (referring to s6 ITEPA but given the law referred to we also think this must cover s62) and expressed the view that they were right in holding that view and that "there is no question of the settlement payment comprising "earnings" for the purposes of the income tax charge". The point was not argued before the Tribunal and no reasons were in any case given for the obiter view.

77. The appellant refers to the First-tier Tribunal's decision in *AB v HMRC* [2011] UKFTT 685 (TC) as an example of where HMRC have accepted that a payment as compensation for unfair treatment is not taxable. That case, concerned whether certain payments made to the appellant upon her leaving two partnerships of which she had formerly been a member were chargeable to income tax because they represented shares of profit or whether they were not taxable because they were compensation which she ascribed to sex discrimination.

78. But the fact HMRC had made that concession does not of course mean that that is the correct position at law. Similarly statements in HMRC's manual which could be read as suggesting that it is accepted that compensation arising from pre-termination matters is not taxable are not relevant to establishing what the correct legal position is. The appellant points out that argument that losses referable to earnings are taxable in some form also sits oddly with the principle derived from *British Transport v Gourley* [1956] AC 185 which suggests that amounts are to be deducted from damages calculated by reference to earnings precisely because if the damages are not taxed the claimant would be in a better position than they would otherwise have been. That case concerned the extent to which damages are to take account of tax. It contemplates that some damages payments may be free of tax and others may not. However, it does not help us on the question of how a particular payment will be treated for tax purposes.

79. We therefore have to return to the words of the statute and the case-law we were referred to on whether payments fall within s62 ITEPA. It is also relevant we think to look at the provisions which found the claim for damages. At the relevant time these appeared in the Race Relations Act 1976 ("RRA 1976") (this has since been repealed but the substance appears along with other types of discrimination against protected characteristics in the Equality Act 2010.) Under s4 of RRA 1976 it was unlawful for the person's employer to discriminate against him by dismissing him or subjecting him to other detriment. Under s54 complaints had to be presented to the Employment

Tribunal. Section 56 enabled the Employment Tribunal to (where it found the complaint well-founded):

> "…make such of the following as it considers just and equitable -
>
> (b) an order requiring the respondent to pay to the complainant compensation of an amount corresponding to any damages he could have been ordered by a county court or by a sheriff court to pay to the complainant if the complaint had fallen to be dealt with under section 57."

80. Section 57 provided that a claim:

> "may be made the subject of civil proceedings in like manner as any other claim in tort or (in Scotland) in reparation for breach of statutory duty".

81. If an Employment Tribunal were to award damages for discrimination (whether calculated by reference to earnings or whether they included injury to feelings) these are recompense for the right not to be discriminated against under statute. They are paid because the employer has breached a statutory obligation not to treat the employee in a detrimental way due to his race. They are treated in like manner to a tort claim. It could be said that where the complaint is of underpayment of remuneration that the damages would not have arisen if 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 *Hochstrasse v Mayes*). 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 under-paid 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 under payment 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.)

Payment made in settlement of a claim bears the same tax character as the claim which it is in settlement of

82. In this case there was of course no order by an Employment Tribunal. There was a payment made under a compromise agreement and a disputed issue between the parties on the evidence as to what that payment was for.

83. In relation to the appellant's submission that payments settling a claim should be treated the same way (to which HMRC did not mount any objection) we agree although we were not referred to any authority on the point that this seems a sensible starting position. The appellant argues that for tax purposes compensation is treated the same whether it is paid as a result of the judgment of the court or to settle a claim

before judgment is given as a matter of principle (why treat settlement of a claim differently from the judgment?) and secondly because it is not clear how else it would be treated.

84. The enquiry into why a payment was made may reveal that there are multiple reasons. Settlements may comprise a combination of various claims which depending on their nature might give rise to different tax treatments under s62 because some claims are not determined to be a reward for services while others are. That is a matter of dispute but before we deal with that there is a further legal issue upon which the parties take a different approach which is the question of what is required to be shown in order to show that a payment is in relation to discrimination.

Is proof of discrimination required?

85. HMRC refer to the ordinary dictionary meaning of "discriminate" which is to "show prejudice" or "distinguish between" and they say there is no evidence that the appellant was treated differently from the other executives other than the appellant saying so.

86. The appellant argues he does not need to prove that discrimination actually took place only that the money was paid in respect of the discrimination claim. (He argues that the evidence points in any event to actual discrimination having taken place.)

87. Further if proof were required the appellant argues that tax tribunal hearings would effectively be turned into employment tribunal hearings with much evidence and perhaps a procedure which amounted to re-service of the discrimination questionnaire. It would discourage settlement as a claimant would think he would have to go to the tax tribunal to prove his case in full rather than accept a reduced offer and avoid trial. The scheme of the employment legislation allows the tribunal to draw adverse inferences where a questionnaire is not answered. In strong cases the employer will most likely realise that answering the questionnaire and making disclosure will undermine its case and will settle early. It would be bizarre, the appellant argues, if the consequence of such early settlement were to be that the claimant was disadvantaged before the tax tribunal.

88. Referring to the Court of Appeal's decision in *Bahl v. Law Society* [2004] EWCA Civ 1070 the appellant argues that in an employment discrimination case all the claimant needs to do is to prove the primary facts of a difference in treatment from which an inference of discrimination will be drawn unless the employer can provide an adequate alternative explanation.

89. We were referred in addition to *Bahl* to various extracts from employment law cases: *Chattopadhyay v Headmaster, Holloway* (EAT) emphasising the difficulties appellants who claim they have been unlawfully discriminated against face and outlining the approach the employment tribunal takes, and *Dresdner Kleinwort Wasserstein Ltd v Mr Abi Adebayo* (EAT) which points out that:

> "it is important to bear in mind that it is unusual to find direct evidence of racial discrimination. Few employers will be prepared to admit such discrimination even to themselves…"

90. The case notes that the inferences that an employment tribunal may draw from the primary facts include inferences under s65(2)(b) of RRA 1976 from an evasive or equivocal reply to a questionnaire.

91. In our view the main relevance of *Bahl* and those other cases is not so much that they indicate that this is the approach we must map across to our fact finding but that they give us an insight into the legal backdrop against which the settlement was negotiated. They therefore add context to our determination of how likely it was that the payment the Bank made was a settlement for a discrimination claim. The above extract is also relevant to the extent that if an employer is unlikely to be prepared to admit direct evidence of race discrimination even to itself then that employer is unlikely to make any admission of liability in the context of an individual settlement and it would not make any admission of liability to race discrimination when asked about it by a third party (in this case HMRC) some time later.

92. Returning to the statute the question is whether the payment was "an emolument of an employment". If an employer made the payment because it thought the appellant had a good claim for discrimination (but in fact the claim was not a good one) in principle we cannot see why that should that make any difference. The crucial element for the purposes of the taxing provision in s62 ITEPA is that the payment is not a reward for past or future services but for something else.

93. In that sense even the appellant's position may require too much of an appellant. We are not required to effectively step into the shoes of an employment tribunal and consider whether we are satisfied there would have been a successful claim at the employment tribunal. But we do need to be satisfied that the reason the payment was made by the employer was (rightly or wrongly on their part) to settle a discrimination claim and not to pay back money which they thought the appellant was entitled to under his service agreement.

94. Having said that the issue of whether or not there was in fact actionable discrimination may not be irrelevant because if there was discrimination this may be more consistent with a finding that the reason for the payment was that the employer felt vulnerable to a discrimination claim. The point however is that it is not necessary for the appellant to show there was discrimination. It is necessary for them to produce sufficient evidence from which it may be inferred that the reason why the payment was made was to compensate for an actual or potential action for discrimination.

95. We come to this view without relying on the appellant's points on what are essentially policy objections to issues of discrimination being litigated before this Tribunal. There is nothing to suggest the procedure for litigating employment discrimination cases and the ability to appeal the tax treatment of sums paid by way of settlement or actual or potential discrimination claims are meant to dovetail neatly together and to be interpreted so as to give a result which does not involve the tax tribunal engaging with issues of whether discrimination did or did not take place. The

point is more about the relevance or otherwise of such facts to the tax issue under appeal which is to establish why the payment was made.

96. We note a conclusion that it is not necessary to show actual discrimination is consistent with the approach taken by the Tribunal in *AB* (referred to above at [77]). In that case which concerned an appellant whose complaint was one of sex discrimination the tribunal said at [35] :

> "…there can be no real doubt that [the appellant] was treated badly, though we do not think it necessary (or even possible) to decide whether she was so treated because of her sex or for other reasons".

97. The Tribunal went onto remark:

> "The only interpretation we can place on the agreement [which was a settlement agreement in which the sum was simply described as a further sum and the amount was expressed to be "in full and final settlement of any claims [the appellant] has or may have against the Firm" and a list of claims she had made / intimated/ recorded to have contemplated] was that while [the firm] was unwilling to make any admission, the partners recognised [the appellant] had been treated unfairly, and that compensation had to be paid."

98. The above approach might suggest it is relevant to be satisfied that there was different treatment but that it is not necessary to be able to say that this was because of the protected characteristic.

99. The different treatment, or the different treatment because of a protected characteristic may be relevant but it is not in our view *necessary* for the appellant to show either of these things when there is at least some evidence from which inferences can be drawn as to why the payment was made. The relevance of the issues of different treatment / different treatment because of the protected characteristic are that findings on such matters would bolster an appellant's case or, if for instance there was no evidence which threw light on the employer's reasons for making the payment, that the findings would provide the foundation for an inference to be drawn that concern over a discrimination claim was a reason why the employer sought to compensate on such a basis (if that is what is argued).

100. HMRC's approach of requiring the appellant to show proof he was treated differently and that this different treatment arose because of his race therefore asks too much of the appellant. In relation to the dictionary definitions of discrimination HMRC have not satisfied us that such dictionary definitions would be relevant to the way a discrimination claim would be approached if it went to the employment tribunal so we think those definitions may be put aside.

101. We have to reach a view on why we think the payment was made. Where the issue is the extent to which the payment was made to settle one or more potential claims then we think it is relevant to take into account the legal and commercial context against which any such claims or potential claims would have been assessed by the employer.

Factual contentions

102.The appellant argues the money was paid in respect of the discrimination claim because of the evidence of discrimination and the absence of countervailing evidence and/or the absence of any other serious explanation for the payment. In short, the appellant says the employer settled early to avoid providing the evidence that would allow the claimant to prove discrimination. By making the payment the Bank was in essence revealing that it thought it would lose before the employment tribunal.

103.HMRC say that if a party has not proved discrimination then why would an employer pay so much money? In relation to the fact the Bank did not answer the race discrimination questionnaire HMRC point out that the Bank may well have had other reasons. It was not required by law to complete the questionnaire.

104.HMRC say it is inconceivable that underpaid bonuses did not form part of the settlement discussions and point to the correspondence from the Bank (the grievance investigation letter (written by E) and in particular the conclusion set out in that letter to the effect that the appellant had been underpaid €209,339 in February 2007). This is yet further evidence the settlement must have comprised earnings. Discrimination means the appellant must have been treated differently and he has not shown this. HMRC also query how the appellant can have known what bonuses others were getting. He did not know what the bonuses of the other MDs were. The fact the appellant was aware from conversations of others receiving bonuses is not satisfactory evidence. HMRC say that without even knowing what percentage bonuses others got this hardly provides safe ground for reaching the conclusion the payment was compensation for discrimination.

105.Also the Compromise Agreement said nothing about compensation and did not use that term.

Evaluation of evidence

106.The obvious place to start is with the Compromise Agreement signed by both parties pursuant to which the sum of £600,000 was paid. The agreement is a standard form and includes a multitude of legislative references within the non-exhaustive list of claims set out in clause 16 which is the clause dealing with "full and final settlement". Amongst the legislation referred to, there are a number of pieces of legislation which appear to have no relevance whatsoever to the appellant's particular circumstances. Despite what the clause says it appears that a number of the claims were not raised or even intimated by the appellant (e.g. personal injury, Data Protection Act damages or age discrimination). We do not therefore think it helps us one way or the other to look at the fact that a claim for discrimination was included within this list or that other matters were on the list as well as the discrimination claim.

107.In order to understand what the £600,000 was for we will need to consider what the parties say about the purpose of the payment, how they acted, and their communications with each other.

108.In terms of what facts we can draw from the evidence the appellant gave, Mr Firth, for the appellant, argues that as HMRC's case that there was no discrimination was not put to the appellant the Tribunal cannot be invited to disbelieve the evidence. However the fact that the appellant was not cross-examined in that way does not, we think, mean that we are bound to accept everything as true. We can consider the inherent plausibility of the evidence, and its internal consistency and consistency with other evidence to see how reliable we find the evidence. In the event, as stated above, we found the appellant do be a credible witness. The only limitations, aside from relevance, we have put on the facts found from his evidence relate to whether his two former colleagues received out of court settlements from the Bank and the reasons for those settlements as it is not clear to us how he would have been able to establish the truth of those matters. (We accept the appellant's belief that such employees received settlements and that he held views as to the reasons why they received those settlements but those beliefs are irrelevant to the issue of the employer's reasons for making the payment.)

109.We also note that the fact the appellant believes the payment he received was for discrimination or that he can set out various instances of discrimination does not necessarily mean that the payment that was made to him by the Bank was referable to his potential discrimination claim.

110.The other point that we have considered with the appellant's evidence is whether there is any risk that it is self-serving in that, having appreciated the tax significance of the settlement being referable to discrimination, he might unwittingly have been prone to emphasise those aspects of his case. However we are satisfied this is not an issue as we can see from the contemporaneous correspondence that he was maintaining that his claim was based on discrimination before the taxability of any sum paid became an issue.

111.As regards Mrs Spalding's evidence this is relevant only in so far as she was able to confirm the correspondence which passed between HMRC and the Bank subsequent to the payment. The request for information she made to the Bank needs to be considered in order to understand its replies.

112.As regards the correspondence from the Bank in the run up to the payment and subsequently upon HMRC's enquiries we think it is reasonable to infer the following in relation to the Bank:

(1) That as the branch of a sizeable financial operation which had a discrete human resources department with access to expertise on the relevant law, it would accordingly be in a position to assess the strengths of its position in any threatened litigation;

(2) that it would act in a way that would best serve its interests and preserve its reputation; and

(3) that it would be unlikely to make any explicit admission that it had racially discriminated against an employee.

113.No witnesses from the Bank were called by either party. We therefore did not have the benefit of having the views expressed by the Bank in its letters being tested in cross-examination or the opportunity to ask employees from the Bank questions.

114.While we note and take into account that the author of the Bank's subsequent explanations to HMRC (F), the senior director of HR at the Bank was also one of the signatories to the Compromise Agreement and that he is reported as having discussions with the appellant on 6 March 2008 we do not know how directly involved that director was in the settlement negotiations. We do not know whether, when he sets out his explanation of the reason for the payment, he is recalling what he actually knew or whether, and if so to what extent, his explanation is derived from what he may have gleaned from other records or conversations with colleagues who were more directly involved.

115.Another point we note is that the scope of the Bank's response was to some extent directed by the way in which HMRC asked certain questions. Whereas HMRC's initial letter simply asked for information relating to what the payment consisted of, its second letter asked specifically whether the Bank believed that the appellant had a contractual entitlement and if so to provide appropriate supporting evidence. The letter did not similarly ask for details of why the Bank did not make a settlement in respect of discrimination and for the evidence supporting that view.

116. The correspondence from the Bank both at around the time of the payment and by way of explanation afterwards must therefore be carefully and critically evaluated.

117. While no oral evidence on behalf of the appellant was put forward apart from that of the appellant himself, we ultimately felt we had sufficient evidence from the appellant and the documentary evidence that was before us to be able to come to a decision. In relation to the appellant's oral evidence, it was our view that he answered the questions put to him in cross examination and by the Tribunal straightforwardly and honestly. He did not appear to us to be taking advantage of the absence of witnesses appearing from the Bank to bolster his case.

118.Having evaluated the evidence, for the reasons discussed further below, we think the payment of £600,000 was made in respect of the claim for race discrimination which the appellant had threatened to make. The Bank did not wish to defend such a claim and the payment was made to settle the claim. Parties making payments by way of settlement of actual or threatened legal proceedings may of course do so for a variety of reasons which are unrelated to the merits of the dispute, e.g. the financial cost, opportunity cost in terms of the time and stress of others. But it is not necessary to apportion what component of the payment related to merits of the discrimination claim and what related to any other of the various possible reasons. Such components only arise as a result of a claim in respect of which, if judgment had been given by the relevant tribunal in favour of the appellant, the resulting sum which would have been awarded would not have been taxable.

119.As discussed above it is not necessary for the appellant to establish that he was in fact discriminated against but to the extent we are able to make findings as to how he was treated we have done so below.

Chronology / nature of dispute being raised by the appellant

120.Although at the outset the appellant was threatening both a discrimination claim and a breach of contract claim, by the time the payment was made it seems clear that the appellant's complaint and the proceedings he was threatening against the Bank were for race discrimination.

121.In the appellant's letter of 28 November 2007 the complaint under the heading "non payment of bonus" is one of unlawful discrimination specifically with regard to bonuses and to pay. It also refers to breach of contract: "I believe I have been underpaid the bonus that I am entitled to expect from the wording of my contract and from the companies dealings with me". And in the conclusion he states "I consider the Bank to be in breach of contract with me and have subjected me to unlawful discrimination on grounds of my racial or ethnic origin."

122.However as the correspondence progresses it becomes clearer that the claim the appellant is pursuing in relation to the bonuses is in relation to race discrimination. There is no mention of breach of contract. Even in relation to the error for the 2006 bonus as conceded by the Bank in its grievance reply letter this sum is, as far as the appellant is concerned, to be rolled up into his threatened discrimination claim.

123.There is no evidence that proceedings covering breach of contract were issued or intimated after the 28 November 2007 letter. On the other hand a race discrimination questionnaire was served as a prelude to race discrimination proceedings. It would have become apparent to the Bank that the appellant was serious in pursuing the claim for discrimination. There would not have been anything which suggested that the appellant was pursuing a breach of contract claim.

124. We have inferred at [45] above that in all likelihood, although the date of the redundancy letter of 26 March 2008 shows that it was sent after the discrimination questionnaire , the letter of 26 March 2008 was written by the Bank's HR Department without them knowing of the questionnaire. The letter offering redundancy pay of £50,000 followed from the meeting on 11 March 2008. It appears quite clear to us that the service of the discrimination questionnaire was instrumental in the Bank putting in place the Compromise Agreement and in offering to pay an additional £600,000.

125. We must however address what the Bank said about its reasons. The Bank's subsequent explanation is that a concern about a claim for an additional 2005 bonus rather than a claim for discrimination made up "the lion's share" of the payment. For the reasons below we are not persuaded this is the real explanation for the payment.

Was the Bank, as it maintained to HMRC, concerned about a contractual claim in respect of 2005?

126.The appellant argues that the Bank's fear of a contractual claim in relation to bonuses makes no sense in that all the appellant could have had was an expectation of a certain sum which would not found a breach of contract claim. Therefore the appellant says the Bank can only have been worried about underpayment of bonuses in the context of a discrimination claim. The appellant also argues it cannot be that there was an enforceable contractual claim in respect of underpayment of the bonus for calendar year 2005 because if a sum was later (in 2006) being promised for work done in 2005 then that work had already been carried out in 2005 and the consideration for the contract would therefore be past consideration. We are not persuaded this is a fair interpretation of what the Bank said on 20 June 2011 that they were concerned about.

127.In our view the Bank's letter of explanation to HMRC of 20 June 2011 in which it expressed a concern about rebuttal witnesses is to be understood as setting out that the Bank had an underlying concern that the discretionary bonus provisions had been orally varied such that rather than the appellant only having an expectation, he had an entitlement to a particular level of bonus in respect of his performance in the calendar year 2005 (or in respect of his performance in calendar year 2006 in relation to a bonus level which as well as reflecting his performance in calendar year 2006 would be calculated in such a way so as to make up perceived shortfalls in his 2005 bonus).

128.Having said that the following facts point against the view that it was a contractual claim on this basis that was the real concern of the Bank when it came to making the settlement payment in 2008.

129.The appellant's follow up letter of 12 March 2008 makes it clear that what the appellant was relying on was not that commitments had been given to him and other MDs in early 2005 by C but that he had discussed the matter in May 2006 with the Chairman and D who agreed a 10% bonus for 2005 payable in February 2007. (E's letter of 6 March 2008 concluded there was no basis for the appellant's view that this discussion had taken place). The 12 March 2008 letter also makes it clear that the appellant did not regard the 2005 bonus matter closed because it was due to unlawful discrimination.

130. It would therefore have been clear to the Bank that the appellant was pursuing his claim for a bonus for the calendar year 2005 on the basis of representations made in 2006 (which could not give rise to a contractual entitlement in relation to calendar year 2005 because the appellant had already been rewarded for the work carried out then through the bonus payment made in February 2006) and also that the sum he was pursuing was sought in the context of a discrimination claim. The Bank would not have had reason to worry about a claim from the appellant for bonus for the calendar year 2005 based on representations having been made in 2006.

131.If it was the case the Bank was worried about a breach of contract claim it seems odd that it waited as long as it did to make the payment. Having taken a robust position in the grievance response there appears to have been no new revelation. The

appellant was not disclosing anything that had not been said before that would have made the Bank's stance suddenly weaker in relation to a contractual claim such that it then made sense to offer a large payment in settlement when only a much smaller payment in respect of redundancy had been offered up to that point. The payment of £600,000 was only made after the race discrimination questionnaire had been served. As we indicated in [124] above the discrimination questionnaire was quite clearly instrumental in the Bank's decision to pay the settlement amount.

Even on the basis of what the employer said it appears that the payments cannot have been purely in relation to contractual claims for salary and bonus:

132.The fact that F, a senior director of HR, (who was in post at the time of the settlement and who must we think have been aware of the general levels of bonus), accepted that the appellant's calendar 2005 bonus paid in February 2006 was very low compared to the profits that the appellant generated appears to suggest that the appellant's level of bonus was not in line with how the bonuses of others were being determined. This is a distinct point separate from any point about assurances being given. To the extent this was part of F's analysis as to why the payment was made it indicates that not all of the rationale for settling was thought to be related to a contractual claim.

133. We also note as the appellant has pointed out that, in relation to the claim for lack of salary increases which is listed as one of the claims in F's letter of 20 June 2011, this claim could only have been founded on a claim for discrimination. The appellant had no contractual entitlement to a salary increase – his claim was purely founded on his allegation that other MDs had received salary increases and the appellant had not and that this was because of his race. In the grievance response the Bank said a significant proportion of MDs did not receive salary increases and the fact the appellant did not receive one was not out of line with treatment of the appellant's peers. The investigation into this aspect of the appellant's grievances found no evidence of less favourable treatment. However, while accepting that the Bank did not want to make any admission of liability, we believe that at least part of the reason why the Bank made a payment of £600,000 is because it did not want to defend a discrimination claim being pursued in relation to salary as well as in relation to the appellant's other claims.

Why the Bank's statement that it did not find discrimination does not necessarily mean the Bank would have felt there was no need to make a settlement in respect of a discrimination claim

134.The Bank's correspondence prior to the settlement payment being made (the grievance response letter of 6 March 2008) and its subsequent explanation of its reasons (the letter of 20 June 2011) report that no evidence was, upon investigation, found of the appellant's treatment being motivated by race discrimination. However neither of these findings would necessarily be inconsistent with the Bank perceiving that it was vulnerable to the risk of a successful race discrimination claim being made against it.

135.If a discrimination claim had proceeded to be litigated before the Employment Tribunal such a claim would not be disposed of in the Bank's favour by showing that

any different treatment was not *motivated* by discrimination. The merits of the claim would require an evaluation of whether the employer was in a position to provide a satisfactory explanation for the different treatment.

136.We also take into account of the points made above at [91] above as to unlikelihood that admissions of race discrimination would be made in correspondence or explanations given by the employer for the payment whether at the time or afterwards.

Relevance of adverse inference provision in relation to discrimination questionnaire

137. We do not think it is open to us to draw any adverse inference from the Bank in not filing a response to the race discrimination questionnaire. The provision is we think directed towards courts or tribunals dealing with discrimination claims under RRA 1976. In any case the employer would still have been well within the eight week time limit to file a response at the time any potential claim was settled. The relevance of the adverse inference provision in s65 RRA 1976 is that from the employer's point of view the service of the questionnaire would have indicated to the employer that the appellant "meant business" with his threat of pursuing a discrimination claim. The employer, the Bank, could not sit back and not respond. In agreeing a settlement, the Bank would have considered the financial costs of mounting a defence of a possible discrimination claim from the appellant and the prospects of winning or losing the case if it went to an Employment Tribunal.

Facts which are not inconsistent with the Bank wanting to make a payment in order to stave off a potential discrimination claim

138.In addition to the factors of the claim being raised by the appellant being one of discrimination rather than breach of contract, and the unlikelihood that the Bank could reasonably be concerned about a breach of contract claim, the following facts relating to different treatment are consistent with the Bank being concerned about a discrimination claim against it even if did not admit liability, and even if did not say that discrimination was a reason for the payment.

139.In relation to salary increases the appellant never received a salary increase while it is clear that some others at his level did. We do not know the ethnic make-up of those who also received salary increases and those who did not. We do not know whether there were any features about their performance which would mean that the appellant's situation was comparable or not to those who received salary increases.

140.In relation to the bonus for calendar year 2003 the appellant's bonus did not reflect the profit which was generated. He was told this was because he was new. We do not know what others were getting and how other new joiners had been treated in their first year. For 2004 the appellant was awarded a bonus which was comparatively low in relation to other MDs and it was not until his allies (B and C) fought his corner that the bonus was increased to around 8% of profit generated. For 2005 he received a bonus of 1% of profits generated which was out of step with others and acknowledged by the Bank to be a low bonus. For 2006 his bonus of 3.5% was also out of step with others and was not increased despite the Bank accepting that it had made an error in its calculations albeit in March 2008 (see [35(2)]). For 2007, while the letter

answering the appellant's grievance stated that E thought it was fair that the appellant should not have received a 2007 bonus as he had not made profits, no response was given then or subsequently to the appellant's claim that he was aware that other employees who had sustained losses for the Bank had received bonuses.

141. While there is no suggestion in the Bank's correspondence around the time of the settlement and in its subsequent correspondence with HMRC that it was concerned about any unfairness related to the appellant's lack of salary increase, the Bank chose to settle the potential discrimination claim relating to bonus and lack of salary increase. There could no doubt be a variety of reasons as to why the Bank chose to settle rather than defend the potential claim including the time and expense of defending such a claim but even if those were the reasons that would not stop the payment being made in respect of the potential discrimination claim.

142. We accept that the appellant was sidelined following the departure of his two former superiors and allies on bad terms (one of them shared his nationality and the other was a different nationality to the others in the executive team).

143. In relation to the disparaging comments which the appellant referred to in his evidence and which related to the appellant's ethnic origin, we did not see any evidence to suggest that the Bank would have been aware that such comments had been made by the time it made the settlement payment. The fact of whether such comments were made is not therefore relevant to the Bank's reasons for settling and we do not therefore go on to make any finding on the point.

144. Even if the above facts were established before an employment tribunal it must be taken into account that all of these matters had the potential to be explained by the employer in such a way that an employment tribunal could be satisfied first that there was not a difference in treatment or that if there was that there was an explanation for the different treatment which was not linked to race.

145. HMRC maintain there is insufficient evidence that the appellant was treated differently. As discussed above we are satisfied he had a rough idea of what others were getting and he knew the precise amounts certain directors were getting through shareholder disclosures. In any case, the issue of what the appellant thought or knew about his peer's bonuses is of limited relevance. The more pertinent question is whether the Bank was proceeding on the basis that he was treated differently. We infer that it was because of the Bank's acknowledgment that his bonus for 2005 was "very low", that there was an underpayment for 2006 as well as it being plausible that verbal assurances as to his profit share had been given to him.

Issue – if we accept the amount was in respect of discrimination query whether the £178k amount for shortfall in the 2006 bonus arose out of error or was the fact it arose also part of the discrimination?

146. HMRC highlight that the £178,922 amount was clearly acknowledged to have been underpaid in error. The appellant's position is that the element of the £600,000 payment relating to 2006 bonus was just as much in response to a discrimination claim as the rest of the payment.

147.It is to be noted that there is no explanation from the Bank as to why it took it so long to identify that a share of profits from a specific country fund had not been attributed to the appellant despite the appellant having drawn his superior's attention to it in strong terms in February 2007 and why, when E promised to instruct payment in March 2008, none was made.

148.What we take from the exchange of e-mails in 2007 between the appellant and D was that D was not denying the conversation as reported by the appellant had taken place or taking issue with the concept of the appellant having his bonus calculated at the level of 10% of profits – D was simply querying the figures upon which the 10% would be calculated and indicating this would need to be run by the Chairman face to face.

149.We note also that no interest was offered in respect of the late payment of this sum and that the Bank did not simply go ahead and pay it, which might have been expected if there had been a pure error. The Bank chose to include it in the settlement negotiation. That is not consistent with treating it as earnings which ought to have been paid but which were not. Also it is not separately mentioned in the Compromise Agreement, which would have been easy to do if it was an undisputed error.

150.The Bank failed to pay the appellant the amount due even after saying that it had made a mistake and would rectify it and it seems likely on the balance of probabilities that the appellant was treated differently.

151.It would have been clear to the Bank that the appellant did not acknowledge the shortfall in the amount he had received arose as a result of an error and that he was intending to encapsulate the shortfall within the discrimination claim.

152.No breach of contract claim was threatened in respect of this amount. However a race discrimination claim was. There is no reason in our view to carve out this amount from the payment. The conclusion is that the whole payment of £600,000 was, although no admission of liability was made by the Bank, a payment in respect of settlement of the appellant's threatened claim for race discrimination.

153.Given the conclusion reached above it is not necessary to deal with the appellant's second argument that, if the settlement was in respect of contractual entitlement to bonuses for 2005 and 2006 then HMRC have amended the wrong year of assessment (and are out of time to amend the assessment for the correct year.)

Conclusion

154.The £600,000 payment was not "earnings" under s62 ITEPA. The appellant's appeal against HMRC's amendment to his self-assessment for 2008-9 is allowed.

Appeal against inaccuracy penalty

Introduction

155.The appellant appeals against a penalty assessment in the amount of £739.72 under Schedule 24 Finance Act 2007 issued on 19 April 2012 in relation to the tax

year 2008-9. The penalty does not relate to tax on the £600,000 payment which is considered above but is in relation to redundancy payments of £48,898 and £1,650 which HMRC say were omitted from the appellant's self assessment tax return for 2008-9 despite the appellant having received advice that these sums were taxable under s401 ITEPA (subject to an exemption for £30,000).

Evidence and findings of fact

156. We heard oral evidence from the appellant explaining how he had gone about completing his return, which HMRC had the opportunity to cross-examine him on. We also had the evidence of Mrs Spalding which the appellant had the opportunity to cross-examine. Her evidence referred to and exhibited copies of the appellant's self assessment return, P45 and payslip and the penalty notice and related correspondence.

157. From that evidence we were able to make the following findings of fact.

158. The appellant was paid a gross amount of £650,548 made up of the £600,000 settlement payment considered above and £1,650 for statutory redundancy and £48,898 for contractual redundancy. The appellant also received pay of £8,842.78 from the Bank from which £2,797.33 of tax was deducted.

159. In total the Bank paid him a net amount of £532,039 having deducted £126,908 at source. The appellant also had gross bank interest of £14,791.54 upon which £2,958.21 had been deducted at source.

160. The appellant received two P45 1A forms from the Bank. Both forms showed a leaving date of 25 April 2008. The figure in the "total pay in this employment" on the first P45 was £620,548.00. The figure in the box "total pay in this employment" was £124,109.60. The second P45 showed the "total pay to date" as £8,842.78 and "total tax to date" was shown as £2,797.33.

161. As confirmed by a letter from the appellant to HMRC dated 26 August 2010 the appellant received advice prior to filling in his return that the first £30,000 of redundancy monies and all of the payment of £600,000 was not taxable. The terms of the Compromise Agreement between the Bank and the appellant dated 9 April 2008 recorded the parties' understanding at clause 10 that the first £30,000 of the statutory redundancy payment of £1,650 and the redundancy payment of £48,898 were not subject to tax.

162. The appellant submitted his tax return for 2008-9 on 10 March 2010. He declared employment income from the Bank of £8,843 with tax deducted of £2,798.

163. In the part of the return dealing with employment lump sums, compensation and deductions under the section (5)"Redundancy and other lump sum and compensation payments" no sum was entered. At (6) ("Tax taken off boxes 3 to 5") the sum of £124,110.00 was entered. At (9) "compensation and lump sum £30,000 exemption" £30,000 was entered.

164.He declared net UK bank interest and details of various sums and a business loss of £23,950 in relation to his self-employment (the appellant later agreed this sum was not allowable).

165.On 3 April 2012 HMRC (Mrs Spalding) wrote to say she was intending to charge a penalty under Schedule 24 Finance Act 2007 because the appellant had omitted from his return the amount of the termination payment that he had been legally advised was taxable.

166.The penalty table and explanation schedule Mrs Spalding sent referred to the period 06/04/2008 to 05/04/2009, to "PLR" (potential lost revenue) of £4,109.80 and the penalty amount of £739.72.

167.On 19 April 2012 HMRC sent the appellant a Notice of penalty assessment which included the amount of £739.72.

168. HMRC's penalty explanation schedule explained that the penalty range was 15-30% based on their view that the appellant's inaccuracy was careless and that the disclosure of the error was "prompted". HMRC's explanation of how the penalty reductions had been applied in relation to the quality of the disclosure was as follows. The maximum reduction of 30% for "Telling" was given as the appellant had admitted he had received the redundancy payment. The 40% reduction for helping was reduced to 30% and the 30% reduction for giving access was reduced to 20% on the grounds that although the appellant had replied to correspondence he had not supplied documentation to support his view the termination payment was not taxable. The total reduction was 80% which, when applied to the penalty range of 15% to 30%, gave a penalty percentage of 18%. Applying this percentage to the potential lost revenue of £4,109.8 gave the figure of £739.72.

169.HMRC's explanation set out that they could not suspend any of the penalty as the omission of the redundancy payment was an inaccuracy that was unlikely to recur and because there were no conditions that could be set to help avoid similar penalties arising in the future.

170.In his evidence the appellant explained the way in which he had approached the task of filling out his self-assessment return as follows.

171.Putting to one side the £600,000 payment he says he had roughly £75,000 gross income less £24,000 for a business loss which came to £51,000. Taking into account that the first £30,000 of the contractual redundancy was tax free (leaving £21,000 taxable) and that his personal allowance for 2008-9 was around £6,000 he had calculated that he was to pay tax on about £15,000 which would work out to be about £4,000. The tax deducted at source (from the payment from the Bank and from his bank interest) was around £130,000 in total. The appellant therefore thought he was due a refund of about £126,000. He says he tried to fill out his online tax return as best he could in order to get a refund of about £126,000 out of the £130,000 which had already been deducted at source. He mentioned the lack of guidance provided on such matters.

Legislation

172.The paragraphs of Schedule 24 that are relevant to this appeal are set out below:

"1(1) A penalty is payable by a person (P) where—

(a) P gives HMRC a document of a kind listed in the Table below, and

(b) Conditions 1 and 2 are satisfied.

(2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to—

(a) an understatement of P's liability to tax,

(b) a false or inflated statement of a loss by P, or

(c) a false or inflated claim to repayment of tax.

(3) Condition 2 is that the inaccuracy was careless or deliberate (within the meaning of paragraph 3).

…

Tax	Document
[…]	
Income tax or capital gains tax	Return under section 8 of TMA 1970 (personal return).
[…]	

…

3(1) Inaccuracy in a document given by P to HMRC is—

(a) "careless" if the inaccuracy is due to failure by P to take reasonable care,

…

4(1) The penalty payable under paragraph 1 is—

(a) for careless action, 30% of the potential lost revenue,

…

5(1) "The potential lost revenue" in respect of an inaccuracy in a document or a failure to notify an under-assessment is the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment.

…

9(1) A person discloses an inaccuracy or a failure to disclose an under-assessment by—

(a) telling HMRC about it,

(b) giving HMRC reasonable help in quantifying the inaccuracy or under-assessment, and

(c) allowing HMRC access to records for the purpose of ensuring that the inaccuracy or under-assessment is fully corrected.

(2) Disclosure—

(a) is "unprompted" if made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy or under-assessment, and

(b) otherwise, is "prompted".

(3) In relation to disclosure "quality" includes timing, nature and extent.

10(1) Where a person who would otherwise be liable to a 30% penalty has made an unprompted disclosure, HMRC shall reduce the 30% to a percentage (which may be 0%) which reflects the quality of the disclosure.

(2) Where a person who would otherwise be liable to a 30% penalty has made a prompted disclosure, HMRC shall reduce the 30% to a percentage, not below 15%, which reflects the quality of the disclosure.

…"

Parties' submissions

173. The appellant argues he had a reasonable excuse for not including the tax of £4,109.80 in his tax return because it was either not clear or not possible for him to do so and to still receive the refund which he reasonably believed he was entitled to.

174.He says the online system was flawed and inadequate in that there was no simple way of inputting all the different components and still getting what he believed to be the correct refund of around £126,000 processed. He went through the permutations and combinations in completing the form in order to achieve the refund result he believed to be correct. He submitted his online application based on the fact HMRC had already had copies of his P45 and PAYE records so according to him they would know exactly what had taken place. He was not hiding anything and his expectation was that if HMRC disagreed they would come back to him. He did not make any false statements and he did take reasonable care to complete his tax return online given the system he had to work with.

175.HMRC say the appellant knew that the redundancy payments of £48,898 and £1,650 were taxable but he did not include these amounts in his self-assessment return for 2008-9.

Discussion and conclusion on penalty

176.There is no dispute that the appellant, by filing a self-assessment return, has provided a "document" of a kind listed in Schedule 24. The question then arises as to whether "Conditions 1 and 2" as set out in the legislation have been satisfied.

177.In relation to "Condition 1" we think this condition has been satisfied. By omitting to include the sum of £20,548 on the return in box 5 ("Redundancy and other lump sum…") but including the tax that was deducted on that amount, the appellant's self-

assessment return contained an inaccuracy which led to an understatement of the appellant's liability to tax.

178. In relation to "Condition 2" and the issue of whether the appellant was "careless", although the appellant has put some of his arguments in terms of his having a reasonable excuse, it should be noted that in contrast to other penalty regimes the relevant legislation does not refer to the term "reasonable excuse". The legislation requires us to consider whether the inaccuracy was due to the failure by the appellant to take reasonable care. We have therefore considered the appellant's arguments with that test in mind. In relation to the relevant standard of care we adopt the test used by the First-tier Tribunal in *David Collis v HMRC* [2011] UKFTT 588 (TC) which was to consider the behaviour of a prudent and reasonable taxpayer in the position of the taxpayer in question.

179.We consider that a prudent and reasonable taxpayer in the position of the appellant, having received advice to the effect that the balance of redundancy monies (after the £30,000 exemption had been taken account of) was taxable, would have taken care to include that sum within the return. In failing to do that the appellant's behaviour fell short of that of a prudent and reasonable taxpayer in the position of the appellant. Further, we do not think the appellant's approach of populating the form in such a way so as to achieve a tax refund figure which he believed he was entitled to, even if this was inconsistent with the information the form asked for, was consistent with the behaviour of a prudent and reasonable taxpayer in his situation. His expectation that it was for HMRC to look at the PAYE and other information they had and contact him if there were any issues was similarly not consistent with the behaviour of such a taxpayer.

180.In approaching the test we consider that a prudent and reasonable taxpayer who had received advice that the £600,000 amount was not taxable but that the remainder was taxable would, having entered an exemption amount of £30,000 have included the balance of £20,548 in the box 5 "Redundancy and other lump sums and compensation payments".

181.The appellant's argument as to the lack of guidance and his argument that the self-assessment online system did not allow him to enter the amounts in such a way that he obtained the refund he believed he was due do not take his case further. The appellant was clearly aware that his redundancy payment exceeded the exemption of £30,000 and inputted the full amount of the exemption. It ought to have been apparent to him that the balance which was taxable should have been included and the box marked "Redundancy and other lumps sums and compensation payments" was the appropriate place to provide that figure even if the appellant said there was no guidance. A prudent and reasonable taxpayer, who had the difficulties operating the self-assessment system which the appellant describes, would have sought to explain those matters in the return.

182.While we accept the appellant had no intention of falsely representing his income, and HMRC do not suggest otherwise, our conclusion is that the error was "careless".

183.The appellant argued that HMRC had not met the burden of proof on them to show there had been an underpayment and had not shown what the potential lost revenue was. There was no underpayment of tax or potential lost revenue because the appellant's tax return produced the correct ultimate figures (subject to the adjustments that been agreed previously with HMRC or which formed the subject matter of the appeal). HMRC needed to show the amount that would have been paid and the amount that was paid and that there was a difference between them.

184.HMRC explained how the figure of potential lost revenue of £4,109 had been calculated. It was 20% of £20,548 (being £50,548 minus the exempt amount of £30,000).

185.We note that as explained above the appellant had not entered any sum into box 5 marked "Redundancy and other lump sum and compensation payments", but had put in £124,110.00 in the tax taken off box (box 6). It is clear that the balance of £20,548 ought to have been captured on the return and that revenue would be lost if the error were not corrected irrespective of the outcome of the dispute in relation to the £600,000 payment. This is because the amount returned for tax deducted at source by the Bank included tax which had been deducted on the £20,548 but that income amount of £20,548 was not then disclosed. If the error was not corrected the appellant would receive a higher repayment than he was entitled to.

186. We reject the appellant's argument that HMRC have not shown the difference between the tax that was paid and the tax that ought to have been paid. It is clear from the reference in paragraph 2(c) of Schedule 24 to inflated claims to repayment of tax that the term "potential loss of revenue" can encompass situations where the repayment sought by the taxpayer is greater than it ought to have been due to the error. The use of the term *potential* reflects the idea that the penalty is not calculated by the actual revenue that is lost but the revenue that would have been lost if the error had not been corrected. The additional amount of tax due is the tax payable on the sum which was not disclosed in error.

187. In terms of the calculation of the penalty amount and the percentage reductions that HMRC decided on, although we did not receive any submissions on this point, we query whether the reason given by HMRC for reducing the maximum reduction of 40% to 30% for "Helping" and for reducing the maximum reduction of 30% to 20% for "Giving Access" makes sense. The reason for limiting the reduction was that the appellant had not supplied any documentation to support his view that the termination payment was not taxable. However it must have been clear, given the basis on which HMRC reached the view that the appellant had made a careless error (he had received advice that the redundancy payments were taxable), that the appellant was not seeking to argue that the redundancy payments escaped tax.

188. Having said that, there was nothing in the evidence to which we were referred to suggest the appellant had, prior to the appeal, supplied documentation or explanations for why the redundancy amounts had been omitted. Although we do not agree with the reasons for HMRC's reductions for "Helping" and "Giving Access" we believe

that those reductions are a fair reflection of the appellant's quality of disclosure and we see no reason to alter the penalty percentage from that applied by HMRC.

189. We did not receive any submissions on HMRC's decision not to suspend the penalty but having considered that matter there is nothing to suggest their decision is flawed such as to allow us to order HMRC to suspend the penalty.

190. We affirm HMRC's decision that the inaccuracy penalty is payable and the amount of the penalty.

Conclusion

191. The appellant's appeal against HMRC's amendment to his self-assessment for 2008-9 is allowed in principle. Should the parties be unable to agree the amount they are at liberty to revert to the Tribunal.

192. The appellant's appeal against the inaccuracy penalty is dismissed.

193. 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.

SWAMI RAGHAVAN
TRIBUNAL JUDGE

RELEASE DATE: 05 MAY 2015