



First-tier Tribunal: clarity on taxation of compensation for discrimination during employment

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A perennial question for lawyers advising on schedules of loss or settlement agreements is whether the sums received by the claimant will be taxable as earnings and therefore subject to income tax and national insurance, collected under PAYE.

Earnings from employment

Earnings from employment are chargeable to income tax under s.62 ITEPA 2003. In addition to salary, wages, etc 'earnings' includes 'anything else that constitutes an emolument of the employment'. As the Supreme Court said in *Murray*, the drafting is in 'deliberately wide terms'. The recent Court of Appeal decision in *Moorthy* addresses the scope of the charge to tax on payments made in connection with termination of employment. Uncertainty remains around the taxation of damages or compensation for discrimination that occurs during employment and otherwise than in connection with termination. Such payments will only be taxable if they are 'earnings'.

In *A v HMRC*, the FTT held that such a compensation payment was not taxable because the source of the payment was the unlawful act of discrimination rather than the employment itself.

Pettigrew v HMRC

In its recent decision in *Pettigrew*, the FTT reviewed the relevant authorities at length and reached the opposite conclusion.

Employment Judge Pettigrew, along with many other fee-paid judges, was the subject of discrimination in his capacity as a part-time worker in respect of payments for training days and the London weighting allowance. His claim, issued in the employment tribunal, was subsequently compromised by the Ministry of Justice on the payment of a lump sum. He argued that the payment was not taxable.

The FTT found that the payment constituted earnings, notwithstanding that: Mr Pettigrew had no contractual entitlement to the additional remuneration received; it was paid as a lump sum; it was paid some years after the relevant services were provided; and the payment was made to compromise a claim (it being common ground that it could make no difference whether the sum was ordered by an employment tribunal or paid to compromise a claim).

In finding that the payment constituted earnings, the FTT was guided by two principles: (a) the character for tax purposes of a sum received as compensation for failure to make a payment due will be the same as the payment it replaces; and (b) the source of a payment made for breach of statutory rights directly connected with the employment will be the employment. Had there been no discrimination and had Mr Pettigrew received greater fees when performing his services for the Ministry of Justice, those fees would have been taxed as earnings. That Mr Pettigrew had to bring a claim of unlawful discrimination to receive the replacement payment did not alter its character.

Conclusion

When advising on the taxation of compensation for unlawful discrimination during employment, the adviser should carefully consider the reason that the payment is made. It is not enough to consider only the mechanism of payment or its immediate cause. When the relevant sum is compensation for non-payment of money that would have been received as earnings in the absence of discrimination, that sum will generally be taxable as earnings under s.62.

KEY:

ITEPA 2003	Income Tax (Earnings & Pensions) Act 2003
<i>Murray</i>	<i>Murray: RFC 2012 plc (in liquidation) v Advocate General for Scotland</i> [2017] UKSC 45
<i>Moorthy</i>	<i>Moorthy v HMRC</i> [2018] EWCA Civ 847
<i>A v HMRC</i>	<i>A v HMRC</i> [2015] IRLR 962
<i>Pettigrew</i>	<i>Pettigrew v HMRC</i> [2018] UKFTT 0240 (TC)