Neutral Citation Number: [2018] EWCA Civ 847

Case No: A3/2016/1369

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
[2016] UKUT 0013 TCC

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 20/04/2018

Before :

LORD JUSTICE UNDERHILL
LORD JUSTICE HENDERSON
and
LADY JUSTICE ASPLIN

- -

Between:

KRISHNA MOORTHY	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

- -
- -

Ms Claire Darwin and Mr Aidan Wills (instructed by **Thomas Mansfield Solicitors Ltd**) for the **Appellant**
Mr Akash Nawbatt QC and Mr Christopher Stone (instructed by the **General Counsel and Solicitor to HM Revenue and Customs**) for the **Respondents**

Hearing date: 6 February 2018

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Approved Judgment

Lord Justice Henderson:

Introduction

1. Following a mediation in January 2011, the appellant taxpayer, Mr Moorthy, agreed to compromise a claim for unfair dismissal and unlawful age discrimination which he had brought in the employment tribunal against his former employer, Jacobs Engineering (UK) Ltd ("Jacobs"). The agreed terms were embodied in a deed of compromise ("the Compromise Agreement") under which Mr Moorthy agreed to accept payment of "an *ex gratia* sum of £200,000 by way of compensation for loss of office and employment", without any admission of liability by Jacobs, in "full and final settlement" of his existing claims and any other claims (broadly defined) arising out of or connected with his employment or its termination, whether or not such claims fell within the jurisdiction of an employment tribunal. Mr Moorthy was then paid the settlement sum in two instalments in the 2010/11 tax year.

2. The main issues which arise on this appeal are:

    a) whether the settlement sum was in principle subject to income tax as employment income of Mr Moorthy under Chapter 3 of Part 3 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003"), which treats as earnings, and thus as taxable employment income, "payments and other benefits which are received [*by the relevant person*] directly or indirectly in consideration or in consequence of, or otherwise in connection with- (a) the termination of a person's employment"; and, if so,

    b) whether the settlement sum (or any part of it) was taken out of charge to tax by the exemption in section 406 of ITEPA 2003, which states that Chapter 3 does not apply to a payment or other benefit provided "on account of injury to… an employee", the alleged injury being the injury to Mr Moorthy's feelings sustained in the context of his age discrimination claim.

    I will refer to these two issues as "the taxability issue" and "the exemption issue" respectively.

3. The taxability issue has so far been determined against Mr Moorthy, and in favour of the respondents, the Commissioners for Her Majesty's Revenue and Customs ("HMRC"), first by the Tax Chamber of the First-tier Tribunal (Judge Redston and Mrs Watts Davies) ("the FTT") in a decision released on 21 August 2014 ("the FTT Decision", [2014] UKFTT 834 (TC), [2015] IRLR 4), and then on appeal by the Tax and Chancery Chamber of the Upper Tribunal (Rose J, President, and Judge Sinfield) in a decision released on 14 January 2016 ("the UT Decision", [2016] UKUT 0013 TCC, [2016] IRLR 258).

4. The exemption issue was conceded by Mr Moorthy before the FTT. The solicitor advocate then appearing for him, Mr David Gray-Jones of Thomas Mansfield LLP, expressly accepted that it was no part of his client's case that the payment fell within the exemption in section 406 of ITEPA 2003 as being for injury or disability: see the FTT Decision at [57]. Before the Upper Tribunal, however, Mr Gray-Jones sought

(and was granted) permission to withdraw this concession. As the Upper Tribunal explained, at [22] of the UT Decision:

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

5. Having heard argument on the exemption issue, the Upper Tribunal held that "injury" in section 406 "refers to a medical condition and does not include injury to feelings": see the UT Decision at [63]. Since there was no evidence that the age discrimination of which Mr Moorthy complained had caused him any recognisable physical or psychiatric injury, as opposed to injury to his feelings, the Upper Tribunal dismissed his appeal on this ground. In so doing, they declined to follow two earlier decisions of the Employment Appeal Tribunal ("the EAT") in the cases of Orthet Ltd v Vince-Caine [2005] ICR 374 ("Orthet") and Timothy James Consulting Ltd v Wilton [2015] ICR 764 ("Timothy James").

6. Apart from the taxability and exemption issues, there are two further subsidiary issues. The first is whether HMRC were right to concede in the closure notice which they issued to Mr Moorthy, and again at the hearing before the FTT, that £30,000 of the settlement amount should be treated as compensation for age discrimination and (as such) within the exemption in section 406. It is now common ground that the answer to this question depends on the correct answer to the exemption issue, and adds nothing to it. Mr Moorthy no longer argues that HMRC should be held to their concession, which was only made in the first place in order to try to reach agreement, if the correct position in law is that the £30,000 was taxable. In particular, it is not alleged that Mr Moorthy had a legitimate expectation that £30,000 of the compensation payment would not be subject to tax in his hands, regardless of the true legal position.

7. The second subsidiary issue concerns an alleged inconsistency with section 124(6) of the Equality Act 2010 (which requires the amount of compensation which may be awarded by the employment tribunal to correspond to the amount which could be awarded by the County Court under section 119 of that Act) if awards of compensation made by the employment tribunal have to be "grossed up" to take

account of the income tax payable under Chapter 3 of Part 3 of ITEPA 2003, whereas compensation awards for other forms of discrimination are not subject to income tax and are therefore paid as a net sum without deduction of tax. As I shall explain in due course, this ground of appeal is in my view misconceived and can be rapidly disposed of.

8. In this Court, each side has been represented by counsel who did not appear below. Ms Claire Darwin, leading Mr Aidan Wills, appears for Mr Moorthy, while HMRC are represented by Mr Akash Nawbatt QC, leading Mr Christopher Stone. In addition, we have the benefit of the helpful written submissions of Henrietta Hill QC on behalf of the EHRC which were submitted to the Upper Tribunal, and upon which the EHRC continues to rely. The EHRC has not, however, sought to intervene any further in this Court, taking the view that its written submissions fully set out its position.

9. Permission to appeal on all grounds was granted by the Upper Tribunal, in a decision notice issued on 4 March 2016. In granting permission, the Upper Tribunal accepted "that there is an important principle involved in this case namely the tax treatment of payments made in respect of discrimination and in particular whether compensation paid for injury to feelings is taxable." The Upper Tribunal also observed that they had arrived at a conclusion different from that of the EAT in Timothy James, and that there were conflicting decisions in the FTT.

Facts

10. The facts as found by the FTT are set out in the FTT Decision at [12] to [35]. Mr Moorthy provided a witness statement, and was cross-examined by the officer then appearing for HMRC. The FTT found him to be "a transparently honest witness". The summary of the facts which follows is drawn from the FTT's findings, and also from the helpful summary provided by the Upper Tribunal in the UT Decision at [11].

11. Mr Moorthy was born in 1952. After beginning work with Kent County Council in 1988, he moved to the private sector in 1999, and in 2008 his employment was transferred to Jacobs following a takeover.

12. By 2007 Mr Moorthy had risen to be executive director of operations at Jacobs. This was an important and responsible post, which carried with it membership of the company's local government services executive management team ("EMT"). He was paid a salary of £111,000 a year, plus pension rights and a discretionary annual bonus in the form of shares depending on the performance of the business.

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

14. This was a shock to Mr Moorthy, who also told the FTT (and they found as a fact) that before this meeting he had not experienced any discrimination while working at Jacobs.

15. Mr Moorthy was unfortunately not successful in obtaining one of the new posts, and on 12 March 2009 he was told that he would be dismissed by reason of redundancy.

He had a 12-month notice period, and was put on garden leave for the whole of that period during which he was paid his normal salary but without any share bonus.

16. A year later, on 12 March 2010, Mr Moorthy's employment was terminated. Shortly afterwards, and before the end of the 2009/10 tax year, Jacobs paid Mr Moorthy statutory redundancy pay of £10,640 from which no tax was deducted.

17. Following his dismissal, Mr Moorthy began proceedings in the employment tribunal, alleging unfair dismissal and age discrimination. His complaint set out the events beginning with the meeting on 4 February 2009 and ending with his receipt of the dismissal letter. Under the heading "Age Discrimination", Mr Moorthy alleged that his dismissal was unlawful under regulation 7 of the Employment Equality (Age) Regulations 2006, because there was a significant gap in age between the five employees who were dismissed and the four who were retained, with the exception of one who had already indicated to Jacobs his intention to retire in three months. Mr Moorthy stated his belief that the scores in the redundancy process had been manipulated to achieve this end, and said that Jacobs had refused to disclose relevant documents despite requests. The remedies which Mr Moorthy sought were:

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

    b) basic and compensatory awards;

    c) compensation for financial loss;

    d) an award for injury to feelings; and

    e) interest.

18. In January 2011, Mr Moorthy and Jacobs engaged in mediation. Mr Moorthy's statement of case began by saying that he was claiming unfair dismissal and age discrimination. In relation to the latter, he submitted that he had shown enough evidence to amount to a prima facie case of age discrimination, and that Jacobs would be unable to prove that no age factors, consciously or unconsciously, had played a part in their decision to dismiss him. In the final section of his statement of case, dealing with remedies, he said that he would have continued working for Jacobs until he was at least 65, that he had taken all reasonable steps to mitigate his loss, that there was insufficient evidence to show he would subsequently have been fairly dismissed for a non-discriminatory reason, and that if his age discrimination claim succeeded, he would be awarded damages for injury to feelings "in the upper *Vento* range".

19. As the Upper Tribunal explained, the "upper *Vento* range" was a reference to the guidance on the assessment of damages in discrimination cases given by the Court of Appeal in Vento v Chief Constable of West Yorkshire Police [2002] EWCA Civ 1871, [2003] ICR 318. Giving the judgment of the Court, Mummery LJ said at [65]:

> "Employment Tribunals and those who practise in them might find it helpful if this court were to identify three broad bands of compensation for injury to feelings, as distinct from compensation for psychiatric or similar personal injury.

> (i) The top band should normally be between £15,000 and £25,000. Sums in this range should be awarded in the most serious cases, such as where there has been a lengthy campaign of discriminatory harassment on the ground of sex or race… Only in the most exceptional case should an award of compensation for injury to feelings exceed £25,000.
>
> (ii) The middle band of between £5,000 and £15,000 should be used for serious cases, which do not merit an award in the highest band.
>
> (iii) Awards of between £500 and £5,000 are appropriate for less serious cases, such as where the act of discrimination is an isolated or one off occurrence. In general, awards of less than £500 are to be avoided altogether, as they risk being regarded as so low as not to be a proper recognition of injury to feelings."

Mummery LJ added, at [66], that there is considerable flexibility within each band, allowing tribunals to fix what they consider to be fair, reasonable and just compensation in the particular circumstances of the case.

20. The Vento bands were subsequently increased in line with inflation by the EAT in Da'Bell v NSPCC [2010] IRLR 19. The maximum which could have been awarded to Mr Moorthy under the uprated Vento bands was £30,000.

21. The mediation was successful, and resulted in the Compromise Agreement to which I have already referred. The key points to note are that the settlement amount of £200,000 was described as "compensation for loss of office and employment"; the payment was made without admission of liability by Jacobs; and it was paid in full and final settlement of Mr Moorthy's claims made to the employment tribunal, together with "any other claims" which the parties might have against each other "arising out of or connected with the employment or its termination". There was no allocation of the settlement amount to different heads of claim, or at all.

22. The £200,000 was then paid to Mr Moorthy in two instalments before the end of the 2010/11 tax year. As provided by the Compromise Agreement, the first £30,000 of the amount was paid without deduction of income tax or employee's national insurance contributions, but income tax at the basic rate of 20% was deducted from the remainder. Jacobs gave no warranty as to the taxable status of the payments made, and Mr Moorthy agreed to indemnify Jacobs for any further tax which Jacobs might be required to pay HMRC in respect of the settlement amount.

23. In his 2010/11 self-assessment tax return, Mr Moorthy said he had received legal advice that the entire £200,000 payment should be tax free, and he asked for a refund of the £34,000 deducted as tax by Jacobs (i.e. 20% of £170,000). Correspondence then ensued between Mr Gray-Jones, who had acted for Mr Moorthy throughout, and HMRC, in the course of which HMRC's technical adviser for termination payments and benefits wrote as follows on 19 September 2012:

> "All of the discrimination complained of is alleged to have taken place during the redundancy process. So any part of the compensation which can be attributed to injury to feelings falls to be taxed under Section 401 as received in connection with the termination of the employment."

24. Eventually, HMRC issued a closure notice on 13 August 2013 which amended Mr Moorthy's original return by removing the £200,000 which he had (on any view inappropriately) claimed as "employment expenses", but allowed two deductions of £30,000, thereby reducing the taxable amount of the compensation payment to £140,000. The first £30,000 deduction was said to represent the threshold amount in section 403 of ITEPA 2003, while the second such amount was offered as a "concession and in order to try and reach agreement", on the footing that it could be treated as damages for age discrimination in the "upper *Vento* range" and outside the charge to income tax.

25. Mr Moorthy then appealed the decision and asked for a statutory review. On 22 November 2013, the review officer confirmed the decision, saying among other things:

> "Strictly speaking in the absence of any settlement or agreement my conclusion should have been that the full amount of £200,000 came under s.401. I did not see anything that would lead me to any other conclusion… however, HMRC have, in their revised assessment, used a figure of £140,023. With that in mind I do not intend to disturb that assessment and therefore accept that figure as the assessable amount."

26. Before I turn to the FTT Decision, it will be convenient to set out the relevant provisions of ITEPA 2003 and also to give a brief description of the legislative history dating back to the first introduction of the charge to income tax on termination payments, in substantially similar terms, in the Finance Act 1960.

Legislation

(1) ITEPA 2003

27. Employment income is charged to tax under Part 2 of ITEPA 2003. By virtue of section 6(1), the charge applies to "general earnings", defined in section 7(3) as including:

> "(b) any amount treated as earnings (see subsection (5))"

Among the amounts treated as earnings under subsection 7(5), are those so treated under Chapter 3 of Part 3.

28. Chapter 3 of Part 3 is headed "Payments and Benefits on Termination of Employment etc". It begins with section 401, which reads as follows:

"**Application of this Chapter**

(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-

(a) the termination of a person's employment,

(b) a change in the duties of a person's employment, or

(c) a change in the earnings from a person's employment,

by the person, or the person's spouse or civil partner, blood relative, dependant or personal representatives.

…

(3) This Chapter does not apply to any payment or other benefit chargeable to income tax apart from this Chapter.

…"

29. The charge to tax is then imposed by section 403, which states:

"**Charge on payment or other benefit**

(1) The amount of a payment or benefit to which this Chapter applies counts as employment income of the employee or former employee for the relevant tax year if and to the extent that it exceeds the £30,000 threshold.

(2) In this section "the relevant tax year" means the tax year in which the payment or other benefit is received.

(3) For the purposes of this Chapter-

(a) a cash benefit is treated as received-

(i) when it is paid or a payment is made on account of it, or

(ii) when the recipient becomes entitled to require payment of or on account of it, and

(b) …

(4) For the purposes of this Chapter the amount of a payment or benefit in respect of an employee or former employee exceeds the £30,000 threshold if and to the extent that, when it is aggregated with other such payments or

> benefits to which this Chapter applies, it exceeds £30,000 according to the rules in section 404 (how the £30,000 threshold applies).
>
> …
>
> (6) In this Chapter references to the taxable person are to the person in relation to whom subsection (1) or (5) provides for an amount to count as employment income."

30. Section 404 then contains detailed rules about how the £30,000 threshold applies. Since there is no longer any issue about the application of those rules, I need only refer only to subsection 404(4) which provides that:

> "If payments and other benefits are received in different tax years, the £30,000 is set against the amount of payments and other benefits received in earlier years before those received in later years."

31. The exemption for payments "on account of injury to …. an employee" is contained in section 406, which reads as follows:

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

(2) Legislative history

32. As I have said, the provisions now contained in Chapter 3 of Part 3 of ITEPA 2003 have their origin in the Finance Act 1960 (sections 37 and 38, and schedule 4). Before then, payments made on or in connection with the termination of a person's employment, such as "golden handshakes", would often be free of tax for either or both of two reasons. First, if the employment had already ended before the payment was negotiated, there would no longer be a "source" which could ground a charge to income tax under Schedule E, which in its then current form provided that tax should be charged "in respect of any office or employment on emoluments therefrom": see section 156 of the Income Tax Act 1952. The second reason was that the payment might well be properly characterised as capital, rather than revenue, in nature, and thus outside the scope of income tax altogether, unless it was paid under a contract of employment, or in some way represented sums which should have been so paid.

33. Furthermore, it is well known to tax lawyers that the correct classification of termination payments is often a difficult matter to determine, and can turn on fine distinctions. As Lord Wilberforce once said, delivering the judgment of the Privy Council on an appeal from Malaysia in 1972 (Comptroller-General of Inland Revenue v Knight [1973] AC 428, at 433):

> "Questions as to the taxability of payments received by employed persons at the end of their employment have frequently come before the courts: they have often been described as difficult, borderline and depending on narrow distinctions. Two propositions are accepted as common ground in the present case. First, where a sum of money is paid under a contract of employment, it is taxable, even though it is received at or after the termination of the employment: see for example *Henry v Foster* (1931) 16 T.C. 605. Secondly, where a sum of money is paid as consideration for the abrogation of a contract of employment, or as damages for the breach of it, that sum is not taxable: see for example *Henley v Murray* (1950) 31 T.C. 351."

34. Against this background, sections 37 and 38 of the 1960 Act provided, in relevant part, as follows:

> "**Payments on retirement or removal from office or employment**
>
> 37 (1) Subject to the provisions of this and the next following section, income tax shall be charged under Schedule E in respect of any payment to which this section applies which is made to the holder or past holder of any office or employment, or to his executors or administrators, whether made by the person under whom he holds or held the office or employment or by any other person.
>
> (2) This section applies to any payment (not otherwise chargeable to income tax) which is made, whether in pursuance of any legal obligation or not, either directly or indirectly in consideration or consequence of, or otherwise in connection with, the termination of the holding of the office or employment or any change in its functions or emoluments, including any payment in commutation of annual or periodical payments (whether chargeable to tax or not) which would otherwise have been made as aforesaid.
>
> …
>
> (4) Any payment which is chargeable to tax by virtue of this section shall be treated as income received on the following date, that is to say-

> (a) …
>
> (b) in the case of any other payment, the date of the termination or change in respect of which the payment is made,
>
> and shall be treated as emoluments of the holder or past holder of the office or employment assessable to income tax under Schedule E; and any such payment shall be treated for all the purposes of the Act of 1952 as earned income.
>
> …
>
> **Exemptions and reliefs in respect of tax under s.37**.
>
> 38 (1) Tax shall not be charged by virtue of the last foregoing section in respect of the following payments, that is to say-
>
> (a) any payment made in connection with the termination of the holding of an office or employment by the death of the holder, or made on account of injury to or disability of the holder of an office or employment;
>
> …
>
> (3) Tax shall not be charged by virtue of the last foregoing section in respect of a payment of an amount not exceeding five thousand pounds, and in the case of a payment which exceeds that amount shall be charged only in respect of the excess:
>
> [*detailed provision was then made for cases of multiple payments in the same or different tax years*]
>
> …"

35. The general scheme of the legislation, therefore, was to treat any payments of the specified description, which were not otherwise chargeable to income tax, as income chargeable to tax under Schedule E received by the taxpayer on the date specified in section 37(4), but subject to the exemptions and reliefs set out in section 38, including (i) the exemption in section 38(1)(a), which is in materially identical terms to that now contained in section 406 of ITEPA 2003, and (ii) the exemption in section 38(3) for the first £5,000 of the amount otherwise chargeable to tax, which is the forerunner of the £30,000 exemption which applies today. Provided that a payment was of the kind specified in section 37(2), it did not matter whether it was of a capital nature, because the section operated by transforming it into deemed taxable income. Furthermore, the section did not apply to any payments which were otherwise chargeable to income tax, so in relation to payments of an income nature its role was residual only. Nor did it matter if the employment had already come to an end when

the payment was made, because the obligation to pay income tax on the payment derived from section 37 itself, without any separate requirement for a taxable source.

36. The regime thus established by the 1960 Act was then re-enacted, in materially similar terms:

a) in the Income and Corporation Taxes Act 1970 (sections 187 and 188, and schedule 8);

b) in the Income and Corporation Taxes Act 1988 (sections 148 and 188, and schedule 11); and

c) in the replaced versions of section 148 and schedule 11, introduced by section 58 of the Finance Act 1998.

37. The provisions were then re-cast in the new format and drafting style of ITEPA 2003, but again without any change of underlying substance. In particular, the language which defines the scope of the provisions, and of the exemption in section 406, can be traced back virtually unchanged to the 1960 Act. The one point which appears not to have been replicated in 2003 is the proviso that the regime applies to any payment of the specified kind which is made "whether in pursuance of any legal obligation or not". Neither side has suggested, however, that any significance should be read into this omission, and the likelihood is that the words were simply thought to be unnecessary.

The FTT Decision

38. After setting out their findings of fact, the relevant legislation, and the submissions of Mr Gray-Jones for Mr Moorthy and of Mr Chapman, the officer then appearing for HMRC, the FTT began their discussion of section 401 of ITEPA 2003 as follows:

> "63. Our starting point is the statute. ITEPA s.401 brings into charge a payment which is "directly or indirectly in consideration or in consequence of, or otherwise in connection with" the termination of a person's employment.
>
> 64. This is a very widely drawn provision. Not only does it catch payments made directly in consideration of a termination, or directly in consequence of a termination, but indirect payments of either type, but is then further expanded to include payments which are not even in consideration or in consequence of a termination but "*otherwise* in connection with" a termination."

39. The FTT expressed their agreement, at [65], with the Upper Tribunal (Judge Gordon Reid and Kenneth Mure QC) in Revenue and Customs Commissioners v Colquhoun [2010] UKUT 431 (TCC), [2011] STC 394, where they said at [12]:

> "The statutory language of s.148(2) [*of ICTA 1988*] has been broadly drawn. That can be seen form the use of words and

> phrases such as "*indirectly*" and "*otherwise in connection with*". "*Otherwise*" may simply mean "*in any way*" and is consistent with the parliamentary intention to catch a wide range of payments".

40. After these introductory observations, which are firmly based on the wording of section 401 itself, the FTT then asked themselves whether the £200,000 compensation payment made to Mr Moorthy fell within the section. They proceeded to answer the question by analysing the facts as found. They pointed out that, on his own evidence, Mr Moorthy had not suffered any discrimination of any kind before 4 February 2009, and he could not have suffered any injury to his feelings before that date. Indeed, all the facts relied on in his complaint to the employment tribunal were bound up with the termination of his employment. Furthermore, his statement of case for mediation followed a similar pattern.

41. The FTT continued:

> "67. On the basis of the facts of this case, we have no hesitation in finding that the payment of £200,000 in its entirety was made "directly or indirectly in consideration or in consequence of, or otherwise in connection with" the termination of Mr Moorthy's employment, and therefore falls within ITEPA s.401.
>
> 68. The only exemptions from that charging provision are:
>
> (1) the £30,000 exemption at ITEPA s.403;
>
> (2) the exemptions at ITEPA s.406 for payments on death, injury or disability, which Mr Gray-Jones accepted was not in point in Mr Moorthy's case [*but see now [4] above*]; and
>
> (3) [*certain other immaterial exemptions*].
>
> 69. Whether or not the payment was also to compensate Mr Moorthy for discrimination, unfair dismissal, injury to feelings, redundancy and/or financial loss is immaterial. It is likewise irrelevant whether or not Jacobs made the payment partly or entirely to protect its reputation. The payment can be any of these things, or all [*of*] them, but because it is "directly or indirectly in consideration or in consequence of, or otherwise in connection with" the termination of Mr Moorthy's employment, it falls within ITEPA s.401. It is therefore unnecessary for us to respond to Mr Gray-Jones's arguments on how the £200,000 should be apportioned."

42. The FTT then reviewed various authorities relied on by Mr Gray-Jones in support of his contention that the payment fell, in whole or in part, outside the broad net cast by

section 401, concluding in each case that there was no reason to change their view that the entire £200,000 was taxable under the section.

The UT Decision on the taxability issue

43. The Upper Tribunal reviewed the case law on the taxability issue at [25] to [42] of the UT Decision. For reasons which I need not elaborate, they convincingly explained why certain earlier decisions at Special Commissioner or FTT level had been mistaken in so far as they held, or appeared to hold, that amounts paid in connection with the termination of employment fall within the scope of section 401 only to the extent that they represent compensation for financial losses. The most influential of those cases was Oti-Obihara v HMRC [2010] UKFTT 568 (TC), [2011] IRLR 386, where the FTT had concluded that £165,000 of the £500,000 settlement payment received by Mr Oti-Obihara represented financial losses caused by the termination of his employment by a US investment bank in London, but the balance was attributable to non-pecuniary loss (notably his claim for racial discrimination) and was not taxable. As the Upper Tribunal pointed out at [38], this approach could not be supported because it ignored the clear statutory wording of section 401. The relevant question is always whether there is "the necessary connection between the payment and the termination of employment".

44. The Upper Tribunal then stated their conclusions on the taxability issue at [52] to [54], as follows:

> "52. We take the same view of s.401 ITEPA as the Upper Tribunal in *Colquhoun* took in relation to s.148(2) of ICTA. We consider that the language of s.401 is clear and its scope is wide… There is nothing in the terms of s.401, read alone or together with the other sections in Chapter 3, that excludes non-pecuniary awards, such as damages for injury to feelings, from the scope of the section. Section 401 is not restricted to payments made under a contractual entitlement or to payments made at the time of termination. The only question that determines whether s.401 applies is whether the payment was directly or indirectly in consideration or in consequence of, or otherwise in connection with the termination of a person's employment. We consider that the FTT was correct, in [69], to disregard the possible reasons for the payment, such as the desire to settle Mr Moorthy's claim for unfair dismissal and injury to feelings or protect Jacobs' reputation, as irrelevant. Once it is established on the facts, as the FTT found in [67], that the settlement payment was, directly or indirectly, in consideration or in consequence of, or otherwise in connection with the termination of Mr Moorthy's employment then it is within s. 401.
>
> 53. We reject Mr Gray-Jones' submission that because the compensation paid to Mr Moorthy was in excess of the maximum amount of compensation which could be awarded for unfair dismissal at the time, the excess must have been unconnected with the termination of Mr Moorthy's

> employment. It does not follow that, because an amount of compensation exceeds the maximum award for unfair dismissal, the payment is not received directly or indirectly, in consideration or in consequence of, or otherwise in connection with, the termination of employment. Section 401 applies to payments made even where the termination of employment was entirely fair and lawful or where the disability or injury were not the fault of the employer and, similarly, to amounts in excess of the statutory maximum award for unfair dismissal.
>
> 54. In our judgment, even damages to reflect non-pecuniary matters fall within s.401 ITEPA if they are connected with the termination of employment (or the other events set out in s.401(1)(b) and (c)). We do not consider that any of the cases relied on by Mr Gray-Jones and the EHRC are authority for drawing a distinction between pecuniary and non-pecuniary loss. Both *Orthet* and *Timothy James* proceeded on the basis that the payments for injury to feelings in those cases fell within the s.401. For reasons set out above, we consider that *Oti-Obihara* was wrongly decided on this point and should not be followed."

The taxability issue: discussion

45. I can deal with this issue briefly, because it is in my judgment clear beyond reasonable doubt that the FTT and the Upper Tribunal were both correct to hold that the entirety of the £200,000 payment to Mr Moorthy fell with section 401(1)(a) of ITEPA 2003. On any natural reading of the statutory language, the payment was received by him "directly or indirectly in consideration or in consequence of, or otherwise in connection with" the termination of his employment. The payment was described in the Compromise Agreement itself as representing "compensation for loss of office and employment". There was no suggestion that any part of it related to anything which occurred before 4 February 2009, when the chain of events was set in motion which led to Mr Moorthy's selection for redundancy and the termination of his employment (after a year's garden leave) on 12 March 2010. The FTT found as a fact that Mr Moorthy suffered no discrimination of any kind before that date, nor did he have any claims for arrears of salary or other payments to which he was contractually entitled. However one looks at the matter, the whole of the payment was at the very least "connected with" the termination of Mr Moorthy's employment, and it cannot possibly be said that either Tribunal erred in law in so concluding.

46. Furthermore, as I have already explained, it does not matter that the payment was made to Mr Moorthy after his employment had ceased to exist, or that it may have been a payment (in whole or part) of a capital nature. Part of the purpose of section 401 and its statutory predecessors is to avoid the need for enquiries of that nature, by the simple expedient of deeming any payments which fall within the statutory language to be employment income charged to tax under the provisions of ITEPA 2003.

47. This statutory deeming also provides the answer to some of the preliminary points taken by counsel for Mr Moorthy in their skeleton argument, where they reminded us of Lord Macnaghten's famous dictum in London County Council v Attorney General [1901] AC 26 at 35, that "Income tax, if I may be pardoned for saying so, is a tax on income. It is not meant to be a tax on anything else." That is undoubtedly true, as far as it goes, but in the modern fiscal world one needs to add the rider that income tax may also be a tax on receipts of any nature which Parliament has decreed are to be treated as if they were income. Similarly, the source doctrine, although far from obsolete in certain contexts, cannot avail Mr Moorthy when confronted with legislation which deems receipts of a certain character to be taxable employment income, whenever paid and whether or not the employment is still in existence.

48. Counsel for Mr Moorthy also advanced a bold submission that the language of section 401 is not in fact widely drawn, and if Parliament had intended any or all connections to suffice, it would not have used the specific terms "in consideration or in consequence of" to limit the residual words in section 401(1). In my judgment, this submission puts the matter the wrong way round. The word "otherwise" before "in connection with" shows that the kinds of connection envisaged by the section must be wider than the specific examples given of payments and other benefits received directly or indirectly in consideration or in consequence of the termination of a person's employment (or a change in the duties of or earnings from that employment). In any event, it is unnecessary for present purposes to explore the outer limits of the kinds of connection which Parliament had in mind, because (as I have already said) it is obvious on any reasonable view that the entirety of the £200,000 received by Mr Moorthy was connected with the termination of his employment.

49. In her oral submissions, Ms Darwin referred to a number of possible factual scenarios, with a view to showing that the approach of the Tribunals below was in some way anomalous, and she also took us in detail to some of the earlier cases (at first-tier level) considered by the Upper Tribunal, including Oti-Obihara. I did not find this exercise helpful, however, because cases of the present type are very fact-specific, and what matters is always the application of the statutory language in section 401(1)(a) to the facts found in the particular case. This was the approach correctly adopted by the FTT and the Upper Tribunal, and I remain wholly unpersuaded that any error of law can be detected in their conclusion on this issue.

50. I would accordingly dismiss Mr Moorthy's first ground of appeal.

The exemption issue: does section 406 of ITEPA 2003 apply to compensation for injured feelings?

51. I now turn to the question whether the exemption in section 406 applies to so much of the £200,000 paid to Mr Moorthy as on a fair apportionment represented compensation for the injury to his feelings as an alleged victim of unlawful age discrimination. I frame the question in this way because the £200,000 was paid without any admission of liability by Jacobs, and there was no agreed apportionment of the global sum between the component parts of Mr Moorthy's claims. Nevertheless, he clearly had at least a prima facie case of unlawful age discrimination, and the relief which he sought in the employment tribunal expressly included an award for injury to feelings.

52. The statutory right to claim damages for injury to feelings in age discrimination cases is now conferred by section 119(4) of the Equality Act 2010, which provides that:

> "An award of damages may include compensation for injured feelings (whether or not it includes compensation on any other basis)."

At the time when Mr Moorthy was made redundant in 2009, the equivalent provision was made by regulations 38(1)(b) and 39 of the Employment Equality (Age) Regulations 2006. Regulation 39(3) said:

> "For the avoidance of doubt it is hereby declared that damages in respect of an unlawful act to which this regulation applies may include compensation for injury to feelings whether or not they include compensation under any other head."

53. As I have already explained, guidance on the appropriate levels of damages for injury to feelings was given by this Court in the Vento case, the uprated upper limit potentially applicable to Mr Moorthy in 2009/10 being £30,000. Vento was a sex discrimination case, but the guidance is equally applicable to cases of age discrimination. The difficulty of assessing appropriate compensation for injury to feelings, as opposed to damages for bodily injury, was well expressed by Mummery LJ in the following passage of his judgment:

> "50. It is self evident that the assessment of compensation for an injury or loss, which is neither physical nor financial, presents special problems for the judicial process, which aims to produce results objectively justified by evidence, reason and precedent. Subjective feelings of upset, frustration, worry, anxiety, mental distress, fear, grief, anguish, humiliation, unhappiness, stress, depression and so on and the degree of their intensity are incapable of objective proof or of measurement in monetary terms. Translating hurt feelings into hard currency is bound to be an artificial exercise. As Dickson J said in *Andrews v. Grand & Toy Alberta Ltd* (1978) 83 DLR (3d) 452, 475-476, (cited by this court in *Heil v. Rankin* [2001] QB 272, 292, para16) there is no medium of exchange or market for non-pecuniary losses and their monetary evaluation:
>
> > "is a philosophical and policy exercise more than a legal or logical one. The award must be fair and reasonable, fairness being gauged by earlier decisions; but the award must also of necessity be arbitrary or conventional. No money can provide true restitution."
>
> 51. Although they are incapable of objective proof or measurement in monetary terms, hurt feelings are none the less real in human terms. The courts and tribunals have to do the best they can on the available material to make a sensible

> assessment, accepting that it is impossible to justify or explain a particular sum with the same kind of solid evidential foundation and persuasive practical reasoning available in the calculation of financial loss or compensation for bodily injury."

54. It is no doubt for similar reasons that in the tort of negligence, where proof of damage is essential to the cause of action, it has long been established that suffering a normal human emotion, with whatever degree of intensity, does not constitute an injury to the person for which damages are recoverable. As Lord Bridge of Harwich put it, in Hicks v Chief Constable of South Yorkshire [1992] 2 All ER 65 at 69:

> "It is perfectly clear law that fear by itself, of whatever degree, is a normal human emotion for which no damages can be awarded. Those trapped in the crush at Hillsborough who were fortunate enough to escape without injury have no claim in respect of the distress they suffered in what must have been a truly terrifying experience. It follows that fear of impending death felt by the victim of a fatal injury before that injury is inflicted cannot by itself give rise to a cause of action which survives for the benefit of the victim's estate."

This bleak logic has no place, however, in the law relating to discrimination on the grounds of sex, race, age or other protected characteristics, where the injury to a person's self-esteem and feelings will typically be a central component of the compensation awarded to a successful claimant. The important question of principle which we now have to consider is whether awards of this nature, expressly authorised in legislation which Parliament has enacted to combat various forms of unlawful discrimination, fall within section 406 of ITEPA 2003 as constituting "a payment… provided… on account of injury to… an employee."

55. If that question is answered in Mr Moorthy's favour, there is no longer any issue about apportionment of the £200,000. At earlier stages in this litigation, he seems to have pursued the unrealistic contention that the whole amount should be treated as falling within section 406. Such an argument could never have succeeded, in view of the constraints imposed by the Vento guidelines and the obvious fact that, on any objective appraisal, a large part of the sum paid to Mr Moorthy must have been intended to compensate him for loss of future earnings and other employment-related benefits. By the end of the hearing before us, however, Ms Darwin was able to confirm on instructions from her client that he would accept the figure of £30,000 which HMRC had originally proposed. We do not understand this to be opposed by HMRC, if they lose on the issue of principle. It would accordingly be unnecessary to remit the case to the FTT on the apportionment issue.

56. As a matter of first impression, I see much force in the argument advanced on Mr Moorthy's behalf that a payment of damages for injury to feelings in the context of an age discrimination claim falls within the plain and natural meaning of section 406. Since section 406 operates by disapplying Chapter 3 of Part 3 of ITEPA 2003, it is only relevant where the provisions of Chapter 3 would otherwise apply, or in other words if the payment in question falls within the scope of section 401. If the payment

is not caught by section 401, and if it is not otherwise subject to income tax, it does not need to be exempted: it simply falls outside the scope of income tax altogether.

57. In the present context, this means that the question of exemption only arises if the damages for injury to feelings are received as (or as part of) a payment made to the taxpayer directly or indirectly in consideration or in consequence of, or otherwise in connection with, the termination of his employment. If Mr Moorthy had not been dismissed, but had made a successful claim for age discrimination while his employment with Jacobs continued, section 401(a) could not have applied; and if the circumstances had been such that the other heads of section 401 were also inapplicable (i.e. if the payment of damages could not be linked to a change of the duties of his employment or a change in his earnings), section 401 would have fallen out of the picture altogether. In that situation, I think it is common ground (and it is certainly my view, as at present advised) that the damages in respect of injury to feelings would not have been subject to income tax at all. The position would have been the same as if Mr Moorthy had been paid damages for a personal injury sustained by him at his work place, or damages for defamation by his employer. Why, then, should the position be different because the payment was made in connection with the termination of his employment? True, the payment is now prima facie taxable under section 401, but that is subject to the exemption (or "exception", as the side-note to section 406 terms it) for payments provided on account of injury to an employee. The injury sustained by Mr Moorthy was an injury to his feelings rather than to his person, but as a matter of ordinary language it was still an injury. That is why we talk of injured feelings, and why the discrimination legislation refers to "compensation for injury to feelings".

58. There is no definition of the word "injury" in section 406, and there is nothing to indicate that it should not be given its ordinary meaning. In particular, the section does not use the term "personal injury", nor is the simple word "injury" qualified in any way, save by the requirement that it must be an injury "to" the employee in question. Since Parliament has now chosen to permit the recovery of compensation for injury to feelings in the context of discrimination claims, what is there to prevent the exemption in section 406 from applying? It is true that the statutory language dates back, virtually unchanged, to 1960, which pre-dates the enactment of anti-discrimination legislation permitting the recovery of damages for injury to feelings; but it could hardly be submitted that the meaning of "injury to… an employee" in ITEPA 2003 is fossilised by reference to the specific types of injury for which damages could have been recovered in 1960. Even in the field of personal injury, there must be many kinds of injury, and psychiatric injury in particular, which were not recognised as such fifty or more years ago. Nobody suggests that section 406 should not apply to all forms of personal injury which are recognised as medical science advances, in accordance with what Bennion on Statutory Construction terms an "updating construction" (see the 7th Edition, 2017, at section 14.1, which states the principle that "Acts are usually regarded as "always speaking"", when "it is presumed that Parliament intends the court to apply a construction that allows for changes that have occurred since the Act was initially framed").

59. The concept of "injury to… an employee" is in my view a good example of an expression which Parliament must have intended to be "always speaking", because medical science never stands still, and Parliament cannot sensibly have contemplated

that the exemption would forever have to be construed by reference to the state of medical knowledge in 1960. But if that is right, it is then surely only a small further step to construe the expression as extending to other forms of injury to an employee which the law may come to recognise, apart from bodily or psychiatric injury. For present purposes, that is as far as the argument needs to go. Mr Moorthy no longer claims exemption for any part of the £200,000 which is not directly referable to his age discrimination claim, and to the award of damages for injury to his feelings which he sought in the employment tribunal.

60. Pausing at this point, therefore, my initial inclination would be to construe section 406 as exempting (at least) payments on account of any injury to an employee which constitutes a recognisable form of personal injury, in accordance with medical science as it develops from time to time, or any other form of injury in the normal sense of that word which is recognised by Parliament as providing a basis for the payment of compensation to the employee. On this approach, an award of damages for injury to feelings made by an employment tribunal to a successful claimant for age discrimination would clearly fall within the ambit of section 406; and if that is right, I do not understand it to be disputed that the same must apply to the appropriate proportion of a global sum paid by an employer in settlement of such a claim, even if (as will usually be the case) the payment is made without any admission of liability.

Authorities on section 406

61. The existing authorities on the construction of section 406, apart from the UT Decision itself, are few in number and do not bind us. They were also fully reviewed in the UT Decision at [43] to [51].

62. Horner v Hasted [1995] STC 766 was a tax appeal, brought by Mr Horner as a litigant in person. After working for many years with a firm of chartered accountants, he took early retirement at the age of 58. He received a severance payment of £90,000, which was assessed to income tax as a termination payment under section 148 of ICTA 1988 (the predecessor legislation then in force). The taxpayer argued that he was not employed by the firm, that the payment of £90,000 was in fact a loan, and that the payment was in any event exempt because it was made on account of disability under section 188(1)(a) of the 1988 Act (the predecessor of section 406). The taxpayer adduced no medical evidence of disability, but invited the Special Commissioner to infer that he suffered from a disability on the basis of evidence which he gave about his mental, emotional and physical condition at the time of his retirement. The Special Commissioner (Dr. A N Brice) decided that Mr Horner had been an employee, and the £90,000 was not a loan and was in principle chargeable under section 148. In relation to the third (exemption) issue, the Special Commissioner said at paragraph 7.18 of her decision (page 797 of the STC report) that she had considered the meaning of the word "disability" in the context in which it was used, and continued:

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

Without the benefit of any medical evidence to assist her, the Special Commissioner was unable to find that this test was satisfied, so Mr Horner's appeal was dismissed.

63. The taxpayer then appealed to the High Court, where his appeal was heard by Lightman J. In relation to the construction of section 188, the judge said, at 800h:

> "It is clear from the language of s188 that for the exemption to be available it must be established: (1) that the disability alleged by an employee is a relevant disability, that is to say, a total or partial impairment (which may arise from physical, mental or psychological causes) of his ability to perform the functions or duties of his employment; and (2) that the person making the payment does so not merely in connection with the termination of employment (compare the language of the exemption of payment made on the death of an employee) but on account of disability of the employee. In short, there must be established as an objective fact a relevant disability and as a subjective fact that the disability is the motive for payment by the person making it."

Lightman J then held that, on the evidence before her, the Special Commissioner had clearly been entitled to find that Mr Horner was not suffering from a disability which disabled or prevented him from carrying out the duties or functions of his employment. The appeal was accordingly dismissed.

64. It will be noted that Horner was a case on the meaning of "disability" in what is now section 406, not on the meaning of "injury". The view of the Special Commissioner that injury, in this context, means a medical condition which prevents a person from carrying out his employment was obiter, and does not appear to have been endorsed by Lightman J. Nor does it appear to have been the subject of any detailed argument, in a case where a multitude of issues was raised by the taxpayer. Furthermore, I can see no warrant in the statutory language for the assumption apparently made by both the Special Commissioner and Lightman J that the disability (or injury) must be one which prevents the person from carrying out his employment. In all the circumstances, I find this case of virtually no assistance on the meaning of "injury" in section 406.

65. The other two cases which I need to consider are Orthet and Timothy James. Each of these was a decision of the EAT, and the relevant issue for present purposes was whether an award of damages for injury to feelings in a sex discrimination claim had to be grossed up to take account of income tax, or whether it was exempt under section 406 (or its predecessor). In neither case was there any dispute between the applicant or her employer and HMRC, and in Orthet HMRC (perhaps unwisely) had declined an invitation to be joined as a party to the proceedings.

66. In Orthet, the judgment of the EAT was delivered by Judge McMullen QC. The applicant had been awarded damages of £15,000 for injury to her feelings by the employment tribunal, on the implicit assumption that this award would not be subject to income tax in her hands. The EAT held that the tribunal had been correct to proceed on this basis, and at 386 set out a list of eight factors all of which in its view pointed in the same direction. The list is quoted in full in the UT Decision at [47], and

I will not repeat it, not least because most of the factors were subjected to cogent criticisms by the Upper Tribunal and are in my opinion of little or no assistance. However, the fifth factor on the list is in my view worth quoting:

> "(e) The exception in the tax statutes of payments made on account of "injury to or disability of the employee" is accepted to include mental and physical injury. Injury to feelings, as expressly included in section 66(4) of the Sex Discrimination Act 1975, carries the dictionary definition of "hurt" and humiliation. Mr Evans argues that injury, wherever it appears, carries with it the same meaning. We agree."

If by this the EAT meant that "injury" must always bear the same dictionary meaning, in whatever statutory context it appears, they were clearly wrong to do so. As the Upper Tribunal said, at [57] of the UT Decision, the meaning of the word "injury" depends on the context in which it occurs. If, on the other hand, the EAT meant that the normal meaning of the word "injury" is relevant to the construction of what is now section 406, I would agree for the reasons which I have already given.

67. The decision in Horner was unfortunately not drawn to the attention of the EAT in Orthet. If it had been, the EAT would have been unable to say that all the factors appeared to point in the same direction.

68. In Timothy James, the claimant had been employed as a director of a recruitment agency. After resigning in acrimonious circumstances, she made claims of unfair constructive dismissal and of harassment related to sex within the meaning of section 26 of the Equality Act 2010. These claims were upheld by an employment tribunal, and in due course she was awarded damages for injury to feelings of £10,000, which the tribunal grossed up to £16,666 to take account of income tax. One of the issues arising on the employer's appeal to the EAT was whether the tribunal had been correct to gross up the damages. The EAT allowed the appeal against the grossing up of the damages, following Orthet.

69. The judgment of the EAT was delivered by Singh J (as he then was). The relevant part of his judgment runs from [61] to [90]. After referring to the relevant legislation, Singh J set out the relevant passages from Horner and then conducted a full review of the decision of the EAT in Orthet. He next referred to Oti-Obihara, where the point had not been the subject of argument, and to certain criticisms of Orthet made by the FTT in the present case, which had taken the view that the leading case in the present context was Horner.

70. Against this rather inconclusive background, Singh J continued as follows:

> "82. In the absence of any binding authority and in view of the conflicting state of such authorities as there are, I consider it important to start with the words of section 406 of the 2003 Act themselves:
>
> "This Chapter does not apply to a payment or other benefit provided- (a) in connection with the termination of employment

by the death of an employee, or (b) on account of injury to, or disability of, an employee."

83. In particular the phrase that falls to be construed in the present context is "injury to… an employee".

84. It will immediately be apparent that that phrase is to be found in paragraph (b) and that that provision is not qualified by the words "in connection with the termination of employment", as the words in the first paragraph are. On the face of it, therefore, it is any injury to an employee which will fall within the exemption.

85. Secondly, it should be noted that, although the sidenote to a statutory provision can be an aid to its construction, it is no more than that. As Lord Reid put it in *R v Schildkamp* [1971] AC 1, 10:

"A side-note is a poor guide to the scope of a section, for it can do no more than indicate the main subject with which the section deals."

Although the sidenote to section 406 refers to an "Exception for death or disability payments and benefits", it is clear from the express words of the provision itself that its scope goes wider than that, since the word "injury" is used as well. The question then becomes what is the correct interpretation of the word "injury" in this context: is it confined to physical injury, or at least personal injury of the kind that can be the subject of a claim for negligence, or is it capable of including injury to feelings?

86. Thirdly, it should be recalled that the decision of the High Court in *Horner*… was concerned with the interpretation of the word "disability" and not the word "injury". At most what was said in that case about the meaning of the latter word was obiter and not necessary to the decision in that case. In contrast the decision of this tribunal in *Orthet*… was concerned with the meaning of the word "injury" and addressed in detail the question whether that concept could include the concept of injury to feelings. It should also be recalled that, on its facts, *Horner* was not concerned with an award of damages for injury to feelings whereas *Orthet* was concerned with that issue and dealt with it at length. Although it is unfortunate that the decision of the High Court in *Horner* was not cited to, nor considered by, this tribunal, I doubt if it would have led to a different conclusion given that it was not directly concerned with the issue which this tribunal was addressing.

87. It was common ground before me that, whilst this tribunal is not bound by its own previous decisions, they will only be

> departed from in exceptional circumstances or where there are previous inconsistent decisions: see *Secretary of State for Trade and Industry v Cook* [1997] ICR 288 (Morison J).
>
> 88. I find that the reasoning of this tribunal in *Orthet* is persuasive. I prefer that reasoning to that to be found in some of the other cases to which I have referred, in particular the recent decision of the FTT in *Moorthy*… I would reach the same conclusion as this tribunal has done previously.
>
> 89. Accordingly, the employer's appeal will be allowed on this ground. The amount of the award for injury to feelings will be varied to be £10,000."

71. It can be seen, therefore, that Singh J followed Orthet, not only because it was a previous decision of the EAT on the same point, but also because he found the reasoning in that case persuasive and preferred it to the approach of the FTT in the present case, which had accorded primacy to Horner.

The decision of the Upper Tribunal on the exemption issue

72. To complete the picture, I must now explain why the Upper Tribunal declined to follow Orthet and Timothy James. The relevant part of the UT Decision runs from [57] to [63].

73. The Upper Tribunal began by criticising the reasoning of the EAT in Orthet. As I have indicated, I find most of these criticisms convincing, and I agree with their conclusion at [58] that Orthet provides "very little support" for the view that awards for injury to feelings, whether in connection with the termination of employment or otherwise, are not taxable.

74. The Upper Tribunal then said that they had carefully considered the judgment of Singh J in Timothy James, and pointed out that he must implicitly have accepted that the amount awarded by the employment tribunal in that case fell within section 401, because if that were not so then Chapter 3 of Part 3 would not have applied and the reference to section 406 would be otiose.

75. The Upper Tribunal continued:

> "60. It is clear that s.406 is not a general exemption from tax for payments on account of injury to an employee. Rather the purpose of s.406 is to take payments to an employee on account of injury outside of Chapter 3 of Part [3] where they would otherwise, by virtue of s.401, fall within that Chapter because they are payments in connection with the termination of a person's employment. It is because s.406 is only relevant where there is a payment in connection with the termination of employment, that we respectfully disagree with the statement of Singh J in paragraph 84 of *Timothy James* that the phrase

> "injury to… an employee" in s.406(b) is not qualified by the words "in connection with the termination of employment". Employment will always terminate on the death of an employee, but the employee's injury or disability will not always lead to termination. Injury or disability could also have other consequences that might lead to the provision of payments or other benefits by the employer to the affected employee. Only some of those payments are covered by s.406(b) because only some of them are covered by s.401, namely those payments made in connection with termination of employment or a change in duties or in earnings. Accordingly, we do not consider that s.406(b) can be read as exempting all *payments made by an employer in respect of an* injury to an employee from tax under Chapter 3 of Part [3]. In our view, "injury" falls to be considered and interpreted together with "death" and "disability" in s.406 because it has to be something which has led to the termination of employment or to a change in duties or level of earnings."

76. Counsel on both sides are agreed that the Upper Tribunal did not state the position with complete accuracy at the end of the passage I have just quoted. While the Upper Tribunal were right to say in the middle of [60] that the employee's injury or disability will not always lead to termination, they were wrong to say at the end of the paragraph that the injury "has to be something which has led to the termination of employment or to a change in duties or level of earnings." In principle, the injury could be wholly extraneous to the employment, and have no effect on the employee's duties or level of earnings, yet still be relevant if the employer chose, for whatever reason, to make a payment on account of it when the employee retired. So, for example, an employee nearing normal retirement age might have been injured in a motor accident, but not so seriously as to prevent him from carrying out his duties as before and at the same salary. If, on his retirement, the employer were then to give him an ex gratia payment in recognition of his injuries, I can see no reason why it should not qualify for exemption under section 406. As the Upper Tribunal rightly pointed out, at [61], sections 401 and 406 do not apply only where the payment is made as a result of some unlawful conduct by the employer.

77. None of these points, however, is of more than peripheral relevance to the present case, where the central question is whether the word "injury" can include injury to feelings. On this critical issue, the Upper Tribunal had little to say except that they considered Orthet and Timothy James to have been wrongly decided, and (following Horner) that they considered "injury" in section 406 to refer to a medical condition, and not to include injury to feelings: see the UT Decision at [63].

78. In reaching this conclusion, the Upper Tribunal considered that Lightman J had accepted the Special Commissioner's view in Horner that "death", "injury" and "disability" in what is now section 406 all refer to medical conditions. Apart from the fact that I find it rather strange to describe death as a medical condition, I am not satisfied that Lightman J accepted the Special Commissioner's view. He gave his own explanation of what he understood "disability" to mean, and then concluded that the

Special Commissioner had been entitled to find on the evidence before her that the taxpayer did not suffer from a disability. His judgment, on my reading of it, went no further than that.

Conclusions

79. Having now reviewed the case law, such as it is, and the relevant part of the UT Decision, I can state my conclusion. I see no reason to depart from the preliminary view which I have already formulated. It seems to me that to treat an award of damages for injured feelings, in respect of actionable discrimination on grounds of age, as falling within the exemption in section 406 would accord with the natural meaning of the language of the section, would provide parity of treatment with similar awards made in a continuing employment relationship, and would not be objectionable on policy grounds. The Vento guidelines show that such awards, if made by a court or tribunal, must be relatively modest in amount, and any attempts to obtain exemption for much larger sums under the guise of a settlement of a discrimination claim would no doubt be rigorously scrutinised by the FTT. The absence of any policy objection to the exemption of payments within the Vento guidelines is brought out by the fact that, until quite recently, HMRC themselves appear to have accepted in many cases that section 406 does indeed apply in those circumstances, and by their offer in the present case to allow exemption for £30,000 of the payment made to Mr Moorthy in order to reach a settlement with him.

80. For the avoidance of doubt, I should make it clear that I express no view on the question whether the exemption might also in principle apply to payments made in respect of injury to feelings where no statutory basis for such a claim could exist. That question does not arise on the facts of the present case, because Mr Moorthy always had a prima facie case of actionable age discrimination. The question must therefore be left for determination if and when it arises in another case. That may in fact never happen, because section 406 has now been amended by section 5(7) of the Finance (No 2) Act 2017, with effect for the tax year 2018/19 and subsequent years, by inserting a new subsection (2) which states that:

> "Although "injury" in subsection (1) includes psychiatric injury, it does not include injured feelings."

The existence of this amendment has no relevance to the question of construction which we have to determine, but it does mean that the scope of the exemption will for the future exclude payments on account of injured feelings.

81. The Upper Tribunal reached the opposite conclusion, but I respectfully consider that in doing so they were unduly influenced by the brief and unsatisfactory reasoning in Horner, which was in any event concerned with the different question of the meaning of "disability". The Upper Tribunal were right to be critical of the reasoning in Orthet, but they should in my view have paid more attention to some of the points made by Singh J in Timothy James, including in particular his criticisms of Horner and his focus on the actual language of section 406 itself.

82. For these reasons, I would allow Mr Moorthy's appeal on the exemption issue.

Subsidiary issues

83. As I have already explained, the first subsidiary issue (ground 3 of the grounds of appeal) does not require separate consideration, because it stands or falls with the answer to the exemption issue: see [6] above. If it matters, the "concession" offered by HMRC to Mr Moorthy in the closure notice, and maintained at the hearing before the FTT, that £30,000 of the settlement amount should be treated as falling within the exemption in section 406, was in my opinion based on a correct view of the law.

84. The second subsidiary issue (ground 4 of the grounds of appeal) raises a question about the equivalency of awards made by the employment tribunal and the County Court: see [7] above. Section 124(6) of the Equality Act 2010 provides that:

> "The amount of compensation which may be awarded under subsection (2)(b) [*i.e. by an employment tribunal which has found a relevant contravention to be established*] corresponds to the amount which could be awarded by the county court or the sheriff under section 119."

85. The effect of section 124(6) has recently been considered by this Court in De Souza v Vinci Construction (UK) Ltd [2017] EWCA Civ 879, [2017] IRLR 844, where Underhill LJ (with whom Lindblom and Gross LJJ agreed) said at [27]:

> "I believe that what that language means is that the amount awarded by an employment tribunal in respect of a particular head of loss should be the same as if an award in respect of the the identical loss had fallen to be made in the County Court. I regard that as the natural meaning of the requirement that the two amounts should "correspond", but if there were any doubt about that I would regard such a construction as necessary to give effect to the evident statutory purpose. The various forms of discrimination defined in Part 2 of the Act are conceptually the same whether the acts giving rise to them fall under Part 5 ("work"), over which the employment tribunals have jurisdiction, or under one of the other Parts where jurisdiction lies with the County Court. The injury to feelings or psychiatric injury caused by an act of discrimination in the workplace is not inherently different from the same injury caused by an act of discrimination in, say, an educational context (which would fall under Part 6). It would be unacceptable for the approach to compensation to be different depending on the Part of the Act under which liability arises – or, more particularly, for an injury of the same level of seriousness to attract a different award; and I think it is clear that the purpose of s.124(6) is to see that that does not occur."

86. The point which is made by Mr Moorthy is that if an employment tribunal were required to "gross up" an award of compensation paid for discrimination, in order to ensure that the applicant would receive a net sum of the appropriate amount, there

would no longer be correspondence with equivalent awards made in the County Court, where (it seems to be assumed) there could be no scope for section 401 of ITEPA 2003 to operate. As I have already indicated, I consider this ground of appeal to be misconceived. There is no difference in the principles which fall to be applied, whether an award is made in the County Court or the employment tribunal. If any damages to which the claimant is entitled would be taxable under Chapter 3 of Part 3 of ITEPA 2003, the award will be grossed up so as to ensure that the claimant is compensated for his actual loss, and not disadvantaged by the incidence of taxation: see Shove v Downs Surgical Plc [1984] ICR 532. It follows that the amount actually received by the claimant will be the same, after the taxation of the award is taken into account, whether the award is made in the County Court or the employment tribunal. There is no question of any breach of section 124(6) of the Equality Act 2010.

Conclusion

87. For the reasons which I have given, I would allow Mr Moorthy's appeal on the exemption issue and declare that £30,000 of the £200,000 paid to him is exempt from income tax under section 406 of ITEPA 2003, being a payment made to him on account of injury to his feelings in the context of his age discrimination claim against Jacobs. I would dismiss Mr Moorthy's appeal on grounds 1 and 4, and make no order in relation to ground 3.

Asplin LJ:

88. I agree.

Underhill LJ:

89. I also agree.