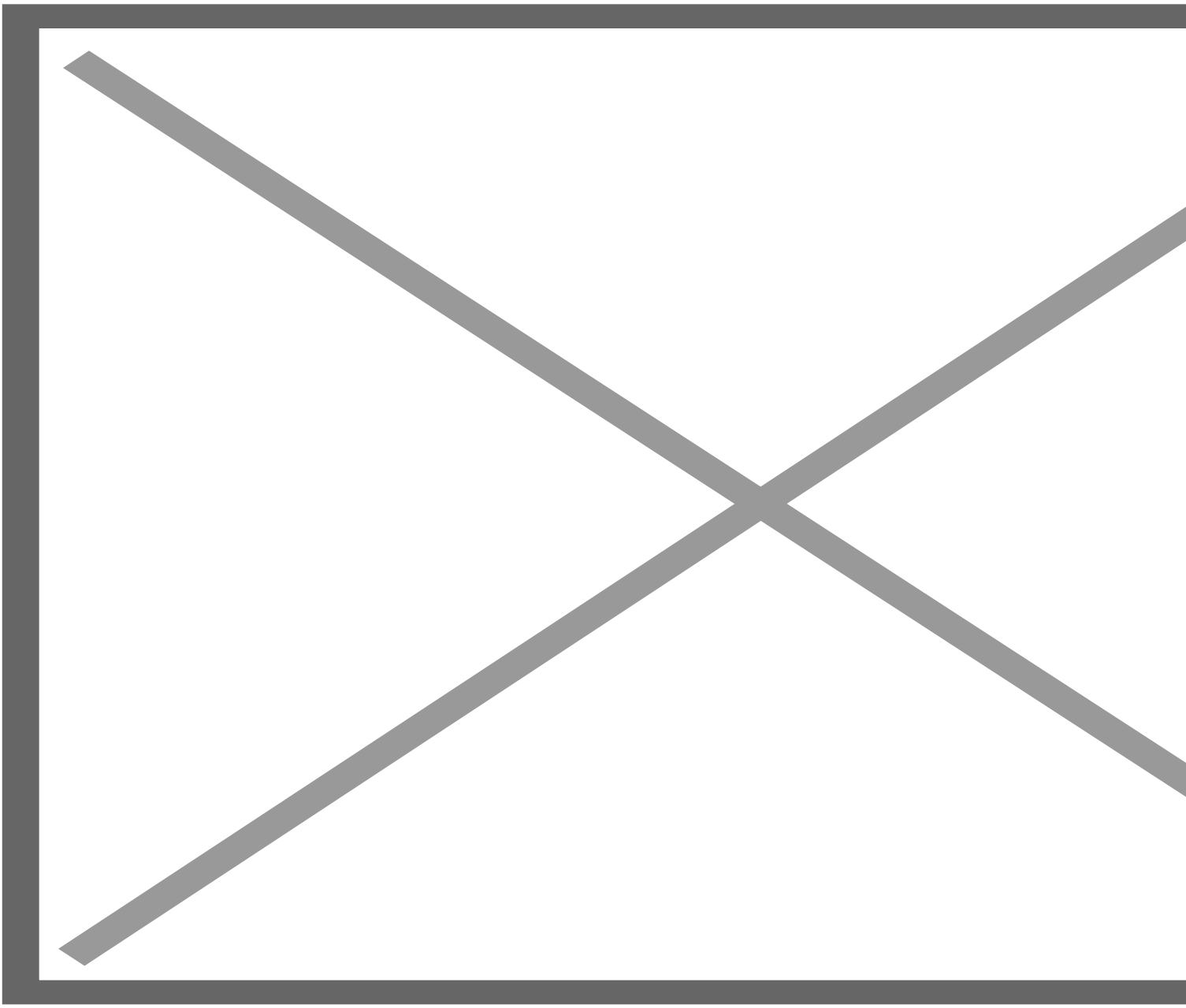
The Terminator

Employment Tax



01 September 2016

Keith Gordon discusses the First-tier decision in *Tottenham Hotspur Ltd v HMRC* [2016] UKFTT 389 (TC) which concerns termination payments paid to transferring footballers

Key Points

What is the issue?

Two players who were being transferred reached an agreement with Tottenham which led to the early termination of their contracts and the payment to each of them by Tottenham of a sum of money. HMRC took the view that these payments did not attract any exemption.

What does it mean for me?

The distinction between those payments that are taxable in full and those that benefit from the £30,000 exemption has regularly cropped up in litigated cases and even more so in cases that do not end up in the Tribunals.

What can I take away?

Subject to the likely prospect of an appeal by HMRC, the Tribunal's decision should be welcomed as making the taxation of termination payments that much more workable in practice.

It is well known that termination payments made to employees can often escape tax, subject to a cap on the exemption of £30,000. Strictly speaking, a distinction is made between payments arising from the employment itself (which are taxable in full as per the normal rules) and those that would otherwise be exempt but for the provisions in the Income Tax (Earnings and Pensions) Act 2003, Part 6, Chapter 3 which bring such payments into the tax net, but for a £30,000 exemption. In most cases (the exceptions now being those with very low or very high incomes), the exemption is worth £12,000 to employees in terms of income tax relief.

Less well known (although clear to most practitioners) is that a similar distinction is currently made for National Insurance Contributions ('NICs') purposes. However, at least until 6 April 2018, there is no £30,000 threshold – payments are either subject to NICs in full or not at all. This gives a marginal additional benefit to employees with the upper rate of primary NICs being 2%. However, given the significant sums that can sometimes be paid in the form of termination payments (particularly in the City of London) and the 13.8% rate for secondary (employers') contributions, the current exemption can often be very valuable to employers.

It was the value of the NICs exemption for employers that led to the appeal by Tottenham Hotspur Ltd ('Tottenham') in this present case.

Facts of the case

Just for completeness, I should mention that Tottenham owns a football club which (for the time being) plays in the top flight of English football (the Premier League). In August 2011, two of its players (Peter Crouch and Wilson Palacios) agreed to join another Premier League club (Stoke City).

At the time of these transfers, the two players still had time to run on their contracts and they could have refused to consent to the transfer. Indeed, Stoke City was unable to offer them the same salary as they were earning at Tottenham and, so, remaining at Tottenham would have had financial advantages to them. Conversely, had they remained at Tottenham, they were less likely to be selected for first-team matches which would have had adverse repercussions on their wider prospects (for example, selection for international matches and opportunities when their contracts did come to an end).

The players were initially reluctant to move. However, they reached an agreement with Tottenham which led to the early termination of their contracts and the payment to each of them by Tottenham of a sum of money.

HMRC took the view that these payments did not attract any exemption. Given the amounts paid, the impact of HMRC's decision from an income tax perspective was relatively modest. However, it had a significant effect from the perspective of employers' NICs – hence, Tottenham's decision to appeal to the First-tier Tribunal.

Although some of the dispute between Tottenham and HMRC concerned the nuanced facts of the case (for example, the extent to which the players were pursuing a move to Stoke City whilst, at the same time, maintaining the position that they were not willing to leave Tottenham), the case essentially boiled down to the following points.

On behalf of Tottenham, it was argued that:

The payments were made in return for the players giving up their employment rights at Tottenham ahead of the expiry of their fixed-term contracts. Thus the payments were not made 'from' their pre-existing contracts of employment.

Whilst it was contended that that conclusion can be reached without first identifying a breach of the original contract, one of the players had been told that he would be unlikely to play first-team football for the remainder of their contract periods and this could amount to an anticipatory breach of his contract.

On the other hand, HMRC argued that:

The players' contracts specifically provided for the early termination of the contracts by mutual consent. Therefore, the payments, which followed such a termination, flowed from the employment contracts.

Secondly, in order for a payment to cease to be 'from' the employment, there had to be a breach of contract by the employer. This did not occur as Tottenham had the right not to select any particular player if it so chose.

The Tribunal's decision

The case came before Judge Jonathan Richards and Member Michael Sharp.

In order to reach their conclusion, they considered the various tiers of rules which govern employment contracts for professional footballers. In the present case, this required the Tribunal to consider the interaction of Premier League rules, the UEFA (the Union of European Football Associations) rules and those of the world governing body FIFA (Fédération Internationale de Football Association) as well as the specific employment contracts themselves.

The Tribunal (disagreeing with an argument put forward on behalf of Tottenham) concluded that there was nothing in those documents, however, that gave players the right to terminate (or to seek to terminate) their contracts after a period of non-selection. Therefore, rejecting the second limb of Tottenham's argument, the Tribunal concluded that there had been no anticipatory breach of the employment contracts by Tottenham.

In respect of the first limb, the Tribunal considered a number of leading cases which sought to identify whether or not a payment was made from an employment and therefore fully taxable (and, in this case, subject to NICs).

In *Henley v Murray* (HM Inspector of Taxes) (1949) 31 TC 351, the taxpayer's fixed-term employment was brought to an end prematurely but the taxpayer was paid the amount he would have received had the contract run

its full course. The Court of Appeal distinguished between cases where an individual accepts a lump sum for a reduction (or elimination) of future duties under the contract and those where the contract goes entirely and the payment is made in consideration for the contractual rights abandoned. It was held that the payment in that case fell within the second category. Somervell LJ left open the question as to what the position would be if there was mutual agreement between the employer and employee as to the abrupt termination of the contract.

In *EMI Group Electronics Ltd v Coldicott (HM Inspector of Taxes)* [1999] STC 803, the distinction was highlighted between payments made following a summary termination of an employment contract and those cases where the employment contract specifically that a payment might be made for early termination of the contract. Such a term (often known as a Payment in Lieu of Notice or PILON) did not exist in the contracts of Messrs Crouch and Palacios. However, HMRC argued that the express terms in the contracts which contemplated early termination were sufficient to make any associated payments ones that arose from the employment.

HMRC relied heavily on the subsequent High Court case of *Richardson (HM Inspector of Taxes) v Delaney* [2001] STC 1328 the facts of which appeared to bridge those of the previous two cases. The employment contract provided for 18 months' notice on either side, with the employer also having the right to terminate immediately subject to making a payment in lieu of notice of a year and a half's salary. In the circumstances, the employee was given notice and asked not to attend the office during the 18-month notice period. In parallel, he was offered immediate termination in exchange of just over a year's salary; following negotiation, immediate termination was accepted in exchange for 15 months' salary and transfer of the employee's company car. The High Court judge considered, in the absence of any breach of contract, that this payment arose from the employment and allowed the inspector's appeal. On behalf of Tottenham, it was noted that Mr Delaney had not been represented in the High Court and that, furthermore, the Judge in that case had not been referred to the distinction cited in *Henley v Murray*. Consequently, it was suggested on Tottenham's behalf that the case was not the most reliable authority.

Another variant of the circumstances was considered in *Hofman v Wadman* (HM Inspector of Taxes) (1946) 27 TC 192. There an employment contract was, by agreement, terminated forthwith subject to the continuance of the salary originally payable. McNaghten J concluded that the original contract was not entirely expunged and the salary payment was therefore made under a remaining aspect of that contract.

Finally, the Tribunal turned to a recent decision of the Upper Tribunal (*HMRC v Martin* [2014] UKUT 0429 (TCC)). Although that case did not consider the question as to whether a payment was from an employment, the Tribunal considered that approach taken by the Upper Tribunal were relevant to the issues before it. In particular, Tottenham relied upon the passage in Martin which referred to the *Henley v Murray* decision, pointing out that there did not need to be a breach of an employment contract in order for a payment to be made otherwise than from the employment.

In its discussion of these cases, the Tribunal disagreed with the proposition put forward by HMRC that active participation by the employee in the discussions leading to the termination could affect the tax treatment of any subsequent termination payment. Furthermore, the Tribunal was not persuaded that there could be a difference simply between those cases where the employment contract contained an express term permitting early termination by mutual consent and those which contained no such term. As the Tribunal noted, such a term did no more than reflect a fundamental principle of contract law.

The Tribunal dealt with the apparent inconsistency between *Richardson* and *Martin*. The Tribunal noted that *Richardson* seemed to involve a Tribunal determining whether or not there had been a breach of the employment contract in order to decide the tax treatment. It considered that this was an undesirable state of affairs, especially as employers and employees often make a pragmatic decision to enter into a compromise agreement specifically

to avoid such matters being litigated. On balance, therefore, the Tribunal concluded that it was not necessary for there to be a breach of the employment contract for the principle in *Henley v Murray* to apply.

Turning to the facts of the present case, the Tribunal concluded that the payments to the players were made 'in return for the surrender of the players' rights' under their respective contracts and, therefore, within the Henley v Murray principle. Consequently, the appeal was allowed.

Commentary

The Tribunal's decision reinforces the general understanding that followed the *EMI v Coldicott* judgment, which was to an extent undermined as a result of *Richardson v Delaney*. Subject to the likely prospect of an appeal by HMRC, the Tribunal's decision should be welcomed as making the taxation of termination payments that much more workable in practice.

In the near quarter-century since I have been practising in tax, the distinction between those payments that are taxable in full and those that benefit from the £30,000 exemption has regularly cropped up in litigated cases and even more so in cases that do not end up in the Tribunals. The gentle erosion of the value of the £30,000 exemption through fiscal drag (i.e. the failure to increase it since 6 April 1988) means that the costs of professional assistance in obtaining the exemption will become increasingly disproportionate. Furthermore, as announced in this year's Budget, the financial incentive to pursue the appeal in the *Tottenham* case (being the total exemption from National Insurance Contributions) will soon be removed as the rules for employer contributions are expected to be aligned with the income tax position from 6 April 2018. Nevertheless, for most workers on packages more modest than those usually enjoyed by Premiership footballers, the £30,000 exemption is still worth fighting for. Therefore, I suspect that this is not the last we have heard on this issue – or, in the words of Arnold Schwarzenegger, it'll 'be back'.

Update on previous case analyses

Further to Keith's article on *Leekes v HMRC* (August 2015), HMRC have successfully appealed to the Upper Tribunal against the First-tier's decision.