Discrimination, Reputation, Mediation and Taxation: *A v Revenue and Customs Commissioners*

by
ERICH SUTER

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1. INTRODUCTION

As Benjamin Franklin wrote in 1789: "In this world nothing can be said to be certain, except death and taxes."[1] *A v Revenue and Customs Commissioners* has now shown, in the context of a mediated settlement arising from employment, that even taxes can be uncertain—but sadly only in the sense of being rather heavier than anticipated.

In this case the employee, A, was a head of department at an investment bank. His salary was £115,000 per annum and his minimum guaranteed bonus for 2000 was $1,833,510. In 2002 A was concerned about certain of the bank's recruitment practices. He took the matter up with the bank and, when he received no satisfaction internally, he reported the bank's practices to the Financial Services Authority (FSA). In October 2002 A was called to a disciplinary hearing which, the bank said, arose out of his breach of the bank's compliance requirements in respect of a particular trade. Although A admitted breaches of the compliance requirements, he nonetheless believed that the disciplinary action was being taken against him to intimidate him because of his complaints to the FSA about the bank's recruitment processes. As a result of the disciplinary process A received a final written warning. He considered that the final warning not only undermined the mutual trust and confidence in the employment relationship between himself and the bank but also that it would have a huge negative impact on his reputation in the City. A resigned on October 9, 2002 with immediate effect. His internal appeal was rejected.

If an employee resigns in response to a fundamental breach of contract by his employer, he is entitled to treat himself as having been "constructively dismissed".[2] This means that he can claim unfair dismissal despite the fact that it is the employee himself who has terminated his employment.[3] In most employment cases, an employee's compensation will broadly be based on anticipated loss of earnings and benefits until the employee finds a new job; together with the costs of finding new employment. In some cases, however, the employee's damages can include an amount to reflect compensation for non-pecuniary losses such as injury to feelings or other damage—typically this will be where employees claim that they have been discriminated against on grounds of sex, race, disability or age, etc. In cases such as A's too, where the employee claims that he has suffered a detriment in employment because he has "blown the whistle",[4] an award of compensation may be made for non-pecuniary loss such as injury to feelings. In this case A maintained that the detriment he suffered was by being unfairly put through the disciplinary process and being given an unwarranted final warning. He maintained that this detriment was visited upon him because he had "blown the whistle" or, as it is more properly put in statute, had "made a protected disclosure"[5]; by disclosing the alleged issues with the bank's recruitment procedures to the FSA. As a result of these detriments A claimed his reputation in the City had been damaged.

* *A v Revenue and Customs Commissioners* Unreported [2009] SPC 00734, Special Commissioner of Income Tax.

1 In a letter to Jean-Baptiste Leroy re-printed in *The Works of Benjamin Franklin* (1817).

2 *Western Excavating v Sharp* [1978] Q.B. 761; [1978] 2 W.L.R. 344; [1978] I.C.R. 221 CA.

3 Employment Rights Act 1996 s.95(1)(c).

4 Employment Rights Act 1996 s.47B.

5 Employment Rights Act 1996 s.43A and 43B.

In January 2003 A brought an employment tribunal claim against the bank. He claimed unfair constructive dismissal and that he had suffered a detriment in employment. Both claims were brought on grounds that the disclosures he had made to the FSA in respect of the bank's recruitment practices amounted to "whistleblowing". A's claim included a claim for damages for injury to feelings.

In addition A's particulars of claim included a claim for loss of earnings and a specific claim for damages for "distress, humiliation and damage to his reputation". Although not addressed in the Special Commissioner's decision, it is fundamental in employment cases that, whilst employees can obtain damages for injured feelings, mental distress and damage to their reputation where the claim is that they have suffered discrimination or a detriment in employment[6]; they cannot claim these types of damages or damages arising out of the manner of their dismissal in a breach of contract claim,[7] or in an unfair dismissal claim.[8] So, as compensation for a claim that an employee has suffered a detriment in employment, an employment tribunal can award compensation for injury to feelings and for loss of reputation, etc. but, in a breach of contract or an unfair dismissal case, it can only award compensation for pecuniary loss.[9]

In July 2003 the parties agreed to mediate A's claims; the mediation took place in September 2003 and concluded successfully with the bank agreeing to pay A £250,000 plus costs. The basis of the settlement was that: A would withdraw his employment tribunal application; the bank would pay A £250,000 plus costs within seven days of its receipt of the tribunal's order dismissing the claim following A's withdrawal of the claim; and the bank would provide an agreed reference for A.

JB, the solicitor who represented A at the mediation, said in evidence to the Special Commissioner that £200,000 of the £250,000 sum should be allocated to damages for loss of reputation.

2. WHY IS THE ALLOCATION OF DAMAGES SO IMPORTANT?

The question of the allocation of damages can be very important to the tax treatment of any settlement monies recovered. Under the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) s.401 "payments and other benefits which are received... [as a] consequence of... the termination of a person's employment" are taxable as income. Under s.403 a termination payment counts as employment income to the extent that it exceeds £30,000. In other words: whilst the first £30,000 of a termination payment is tax free, the remainder is taxed at the employee's marginal rate.[10] Where a payment is made for damage to reputation or for injury to feelings, however, it is not prima facie subject to tax—unless, of course, it is found to have been paid as a "consequence of... termination of... employment", s.401.

JB's justification for the allocation of £200,000 of the settlement monies to damage to reputation was that the limit of compensation which an employment tribunal could award in normal unfair dismissal claims at that time was £52,600. Although there is no upper limit to the amount of compensation which an employment tribunal can award in a whistleblowing case, JB gave evidence to the Special Commissioner doubting that an employment tribunal would have awarded A more than the normal statutory maximum for the loss of earnings element of his claim. The Special Commissioner rejected this argument. He held that the rationale for this split between compensation for loss of earnings and compensation for loss

[6] In this case because of whistleblowing under Employment Rights Act 1996 s.47B.

[7] *Addis v Gramophone Co Ltd* [1909] A.C. 488; [1908–10] All E.R. Rep. 1 HL.

[8] *Dunnachie v Kingston-upon-Hull City Council* [2004] UKHL 36; [2005] 1 A.C. 226; [2004] 3 W.L.R. 310 HL.

[9] *Dunnachie* [2004] UKHL 36; [2005] 1 A.C. 226; [2004] 3 W.L.R. 310 confirming *Norton Tool Co Ltd v Tewson* [1973] 1 W.L.R. 45; [1973] 1 All E.R. 183; [1972] I.C.R. 501 NIRC.

[10] This tax-free allowance is not invariably available, e.g. where there is an existing contractual right to a payment on termination it may be taxable anyway.

of reputation put forward on A's behalf was one which "did not withstand serious legal analysis".[11]

3. ISSUES LEADING TO THE DECISION ON TAXATION

There were a number of practical evidential difficulties in this case: there had been no schedule of loss prepared prior to the mediation (a schedule of loss would, of course, have set out the various elements claimed under each head of damages). The negotiations during the mediation had been conducted on the basis of global figures rather than by attributing any particular amount in the negotiated figures to particular elements of A's claim. The loss of earnings which the claimant had intended to claim, had the case gone to a tribunal hearing, was in the region of $3 million to $4 million, so the settlement figure was not disproportionate to A's anticipated loss of earnings claim. But, above all, the Special Commissioner found[12]:

> "[A's] principle weakness... was [A's] failure to undermine the compelling evidence of the settlement agreement which demonstrated a direct link between the compensation and the termination of [A's] employment. The settlement was agreed to by [A] having been advised by his solicitor. Under the terms of the agreement the compensation... was payable on withdrawal of his [tribunal] claims. Those claims, except that for injury to feelings, were directly related to [A's] dismissal."

It followed that, since the "damage to reputation" claims related directly to the claimant's dismissal, they were "payments... received... [as a] consequence of... the termination of [A's] employment" and, as such, caught by the charge to tax under ITEPA 2003 s.401.

It seems to me that, in reaching this decision, the Special Commissioner has ignored the "detriment" part of the claimant's claim; which is the only part of the claimant's claim which could have given rise to a claim for "damage to reputation" compensation in an employment tribunal. The effect of the Special Commissioner's decision appears to put the cart before the horse and to do an injustice to the reality of the situation. A's reason for leaving employment was his concern about the damage he feared the warning would do to his reputation. If the damage to reputation element of the compensation had been dealt with in the settlement agreement by specifically linking it to the "detriment in employment" part of A's claim, then it appears that no tax would have been chargeable. The "detriment in employment" predated, and indeed led to the employee terminating his employment. Indeed the Employment Rights Act 1996 s.47B(2)(b), which deals with detrimental treatment for whistle blowing, specifically excludes cases where the detriment "amounts to dismissal". So the loss of reputation damages must have been incurred before A's employment terminated rather than just being part of the overall payment made "as a consequence of" that termination. A further irony is that, whilst the Special Commissioner found that the bank's having given A a final warning was not unreasonable in the circumstances, nonetheless, as A feared, news of the situation did get out and A had been unemployed for some years by the time of the appeal before the Special Commissioner; indeed he had had to move into a completely different field of work altogether. Perhaps a further indication that his fears for his reputation were justified, significant, specific and genuine.

4. WHERE DOES THE MEDIATOR'S ROLE FIT INTO THIS?

In my experience as a mediator who has been involved in many discrimination and employment mediations, whilst it is not a mediator's job to give the parties legal advice, nonetheless it is important to draw the parties' attention to any major issues that might

[11] *A v Revenue and Customs Commissioners* Unreported [2009] SPC 00734 at [34] and again at [44].

[12] *A v Revenue and Customs Commissioners* Unreported [2009] SPC 00734 at [45].

affect a mediated settlement. One example I am reminded of is a case where a set of solicitors had to be reminded, at the point where the terms of settlement had been agreed, that in an employment case (as that was) a compromise agreement had to be entered into which contained specific elements if it was to be effective to settle the claim. In the same way, mediators who deal with employment and discrimination cases, where issues of the type highlighted in *A v Revenue and Customs Commissioners* arise, should ensure that the parties' eyes are drawn, if not to the tax efficiency of the settlement,[13] at least to the utility of allocating specific elements of the settlement to particular elements of damage. This is particularly so in cases where it is apparent from the issues under discussion that part of the settlement monies are for damages which should not be caught by a charge to income tax.

5. ANY ALLOCATION OF DAMAGES MUST BE REALISTIC

Obviously, if different elements of a settlement are to be separated, it is important to allocate those parts of the settlement to the appropriate head of damage on a proper basis. It is, of course, important in doing so to have a clear eye to the difference between tax avoidance and tax evasion in this context.[14] But, having said that, if A's solicitor had made clear at the mediation, as he did in his evidence at the appeal to the Special Commissioner, that A's main concern was in terms of the damage to his reputation and if the damages had been allocated accordingly in the final settlement, then the Special Commissioner may have made a quite different decision.

When looking at the question of allocation of the settlement monies to specific elements of a settlement, it will generally be important for the parties to the mediation not only to have in mind the fact of separate allocation of different elements of the monies to be paid but also a realistic assessment of quantum in relation to each of those elements. In *A v Revenue and Customs Commissioners* itself, for example, the one "non-s.401 termination payment" element which the Special Commissioner was prepared to allow was the element of damage for injury to A's feelings. This was the one element which the Special Commissioner considered did not arise from the termination of A's employment and was thus not caught by s.401.[15]

In relation to injury to feelings claims, the Court of Appeal in *Vento v Chief Constable of West Yorkshire Police*[16] set out three "bands" within which injury to feelings might fall in any case. The top band of between £15,000 and £25,000 is for the most serious cases. This is where there has been a lengthy campaign of discriminatory harassment against the claimant. The middle band of between £5,000 and £15,000 is for serious cases which fall short of the highest band; and the lower band of between £500 and £5,000 was held to be appropriate for less serious cases, such as isolated acts of discrimination.

In A's case it was argued that the injury to feelings element was in the highest category. But the Special Commissioner considered that "[t]he circumstances relied upon [by A]

[13] Which must be the responsibility of the parties and their advisers to ensure.

[14] The concept of tax avoidance, which is lawful, was explained by Lord Wilberforce in *WT Ramsay Ltd v Inland Revenue Commissioners* [1982] A.C. 300 at 323; [1981] 2 W.L.R. 449: "A subject is entitled to arrange his affairs so as to reduce his liability to tax. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. It must be considered according to its legal effect." In the US the same rule was expressed by Hand J. in *Helvering v Gregory* 69 F.2d 809 (1934): "[A]nyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes... there is nothing sinister in so arranging affairs as to keep taxes as low as possible... for nobody owes any public duty to pay more than the law demands. Taxes are enforced exactions, not voluntary contributions."

[15] See at para [46].

[16] *Vento v Chief Constable of West Yorkshire Police* [2002] EWCA Civ 1871; [2003] I.C.R. 318; [2003] I.R.L.R. 102 CA.

lacked objectivity".[17] Looked at objectively the Special Commissioner restricted the injury to feelings element to the mid-point of the middle band, i.e. £10,000. Again, whilst specifically agreed terms of settlement in relation to the injury to feelings element of A's claim may well have placed the settlement figure in respect of this element in the middle band, it might have been much more difficult for the Special Commissioner to have re-assessed an agreed figure if the parties had agreed in their settlement to compensation for injury to feelings at a higher point in the middle band.

6. CONCLUSION

In any employment case, especially cases involving discrimination or whistleblowing claims,[18] where there is, or may be, an element of injury to feelings, damage to reputation, personal injury or any other element which looks, on the face of it, not to be taxable, it would helpful for mediators to remind the parties that, whilst getting a settlement may be the primary purpose of the mediation, it is sensible to make sure that the settlement is fiscally sound.

And Benjamin Franklin too would no doubt appreciate the irony inherent in putting specific effort into trying to make the impact of taxation even more certain.

NOTE

The three "bands" within which injury to feelings damages can be awarded, established in *Vento v Chief Constable of West Yorkshire Police* (see above: 5. Any Allocation of Damages Must be Realistic), have recently been reviewed by the EAT in *Da'Bell v NSPCC*. This unreported judgment was handed down on September 28, 2009 but no transcript is yet available. The EAT increased the level of *Vento* damages to allow for inflation. The upper point of the lower band is raised from £5,000 to £6,000; the top levels of the middle and upper bands are increased from £15,000 to £18,000 and from £25,000 to £30,000 respectively.

[17] See *A v Revenue and Customs Commissioners* Unreported [2009] SPC 00734 at [49].

[18] Perhaps also on the other side of the fiscal coin an eye needs to be kept on cases involving confidentiality agreements and restraints of trade which give rise to separate tax charges.