BCLP. Client Intelligent

Insights

UK HR TWO-MINUTE MONTHLY: DECEMBER 2022

SETTLEMENT AGREEMENTS, VANISHING DISMISSALS FOR GROSS MISCONDUCT, (LACK OF) MITIGATION AND GENERAL NEWS ROUNDUP

Dec 15, 2022

SUMMARY

Our December update includes new case law on a very unusual take on taxing payments under settlement agreements, how difficult it can be to withdraw an appeal and stop a dismissal from vanishing, and the consequences, even if you win, of not mitigating your loss by trying to find alternative work. It also includes news updates on the ICO guidance on employee health and safety, accent bias in the workplace, and ethnicity pay gaps.

SETTLEMENT AGREEMENTS - CAN £1M BE PAID FEE OF TAX?

In a case in the tax tribunals last month, an ex-employee appealed against HMRC's decision to tax the vast majority of her £1,055,000 (£1m) termination payment. The payment was made under an ordinary looking settlement agreement, with the first £30,000 paid free of tax and the reminder of the payment, a large sum, taxed. Under the settlement agreement, the employee was also paid a tax-free payment of £45,000 for injury to feelings.

If successful this challenge would potentially disrupt the way in which settlement payments are structured and paid day-to-day.

The vast majority of payments under settlement agreements are paid under sections 401/403 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). These sections apply to non-contractual payments paid on termination of employment and allow the first £30,000 to be paid free of tax. These sections apply only to "non-contractual" payments, and (a) they do not cover payments made under the employment contract, such as outstanding holiday and payments in lieu of notice, which are fully taxable and (b) they do not cover payments made in return for the employee entering into "restrictive undertakings", such as restrictive covenants and confidentiality restrictions. Restrictive undertakings are covered by s225 of ITEPA, and again are fully taxable. We return to s225 below.

The employee's main argument was that the payment was not related to the termination of her employment. She argued her departure was a voluntary resignation, and the whole payment was made for her entering into secrecy and non-disclosure (NDA) provisions in the settlement agreement. She said that both her employer and its founder were paying only for her silence. As the payment was not made in connection with the termination of her employment, it fell outside s401.

However, this potentially put the employee in a worse position. She argued that the whole payment was made in return for her entering into NDAs and confidentiality provisions. As stated above, however, payments made in relation to "restrictive undertakings", such as NDAs and confidentiality provisions, are fully taxable under s225 of ITEPA. It states in s225(1) that:

> "This section applies where an individual gives a restrictive undertaking in connection with the individual's current, future or past employment…"

This surely applies to a payment made in return for NDAs and confidentiality provisions and might not be the best argument for the employee. A s225 payment is fully taxable, whereas a s401 payment at least has the first £30,000 free of tax.

However, the employee argued that s225 did not apply to the payment either, and advanced a unique argument. The employee argued that s225 had to be read in a special way, with s225(8) importing words from s225(1).

This takes some following but it is the core of the case. S225(8) defines a "restrictive undertaking" as an undertaking which "..restricts the employee's conduct or activities..". The employee argued that the words "..in connection with the individual's current, future or past employment", should be taken straight from s225(1) and inserted into s225(8) so that the "conduct and activities" referred to in s225(8) are only those relating to employment, as stated in s225(1). The employee said that no aspect of her employment was affected by the NDAs/confidentiality obligations so, under her unique interpretation, s225 did not apply to her payment.

She argued that, because the £1,055,000 was not a termination payment under s401, and not a restrictive undertakings payment under s225, it was free of tax. Needless to say, HMRC and the tax tribunal did not agree. The main reasons for this were:

- The wording of the settlement agreement contradicted the employee's argument that the payment did not relate to the termination of her employment. The payment was made under clause 4 of the settlement agreement and the wording was not favourable to the employee's argument. The payment was made - "…as compensation for the termination of [the employee's] employment and any and all claims [she] has or may have had against the Employer, the Owner etc…". There was no mention of NDAs and confidentiality provisions, but plenty about termination of employment;

- There were quite draconian NDAs, non-disparagement and confidentiality provisions contained in the settlement agreement, but no sums were paid in return for them. It is difficult to argue that a termination payment is only paid for NDAs and confidentiality provisions when no money is stated to be paid for them. If the employee (for example) had a separate NDA with £1m paid for entering into it, it might have helped her case;

- The employee's interpretation of s225, on which a great deal of her argument rested, was not accepted by the tax tribunal. The tribunal said that the meaning of restrictive undertaking was as stated in s225, and there was no authority or precedent to suggest that s225(8) should have wording from s225(1) added to it. The tribunal held that the restrictive undertakings in the settlement agreement fell within the clear meaning of s225 (as s225 is drafted).

As the employee had insisted that the payment was made in return for NDAs and confidentiality provisions, the tribunal held that the payment was made in return for the employee entering into "restrictive undertakings" and therefore HMRC taxed the whole £1m under s225. The payment was taxed in full, with no £30,000 exemption, which is only available under s401. This left the employee worse off than when she started.

The tribunal said that, even if they were wrong about the payment falling under s225, the wording of s401 was so wide that the payment would fall into s401, particularly bearing in mind the wording of clause 4 of the settlement agreement, which placed it fairly and squarely as a payment made for termination of employment, without any mention of NDAs or confidentiality.

WHY THIS MATTERS

Although this might appear to be a technical tax case, its implications are significant for the way in which settlement agreements are prepared and entered into every day.

It illustrates that the existing tax regime relating to settlement agreement is difficult to challenge, and that ingenious/inventive/unique arguments are likely to receive little traction at tax tribunals.

Mrs A –v- HMRC

DO DISMISSALS THAT ARE SUCCESSFULLY APPEALED ALWAYS "VANISH"?

The idea of a "vanishing" dismissal is reasonably well-known in employment law. It happens where an employee is dismissed, but the employee then successfully appeals the dismissal and is reinstated. The original dismissal "vanishes" because it has been overridden by an appeal and reinstatement.

But what if the reinstated employee does not want to be reinstated and does not want the dismissal to vanish?

The claimant was a part-time Sales Assistant. She was summarily dismissed for gross misconduct in/around January 2019 – she was alleged to have left the till unattended with customers present, which the claimant accepted, and to have shouted and behaved aggressively towards a trainee Manager, which she did not accept.

The claimant appealed her dismissal. The respondent upheld the appeal, replaced the decision to dismiss with a final written warning, and reinstated the claimant with effect from April 2019, with back pay and preserved continuity of service. So far so good.

But the claimant was far from happy. During the appeal process in January-March 2019, she made her strong views about the respondent well known. Although she had appealed her dismissal, she appeared to be unsure whether she wanted to continue with her appeal. She said she did not want to work for the respondent and that all she wanted was compensation. She said that the trust between her and her employer had been broken. The claimant's argument, essentially, was that the cumulative effect of her words was that she had withdrawn her appeal.

So when she was told in April 2019 that her appeal had been successful and that she was reinstated, the claimant simply refused to accept it. She did not return to work for this reason. Her view was that she had withdrawn her appeal - her January dismissal had not "vanished", it was still very much in existence. She said she remained dismissed with effect from January 2019 and that that dismissal was unfair.

After her reinstatement, three months passed and the claimant did not return to work. She was ultimately dismissed for a failure to attend work. The matter ended up before the tribunal.

The tribunal agreed with the respondent that the claimant's original January dismissal had vanished because of her subsequent appeal and reinstatement. The tribunal referred to the 2019 case of *Folkestone Nursing Home Ltd –v- Patel* as the most recent and clear authority on the point, which showed that an employee can only escape the consequences of a successful appeal in law if the appeal is clearly withdrawn. The tribunal's view was that, although the claimant had been uncompromising about her negative views of the respondent and her desired outcome, she had not actually said that she wanted to withdraw her appeal. She had also not formally withdrawn the appeal because of advice from ACAS.

The claimant appealed the tribunal's decision.

The EAT agreed with the decision of the tribunal. It held that the tribunal had not erred in law by holding that the claimant had not withdrawn her appeal. It followed that the decision to allow her appeal had resulted in the claimant's reinstatement. The EAT, as a clarification point, also looked at what amounts to an appeal. In particular, the EAT reiterated that the Claimant's words of "*I don't*

want to work for [the respondent]" did not constitute a withdrawal of her appeal against dismissal, which was the claimant's main argument. The EAT held that:

- the 'withdrawal' of the appeal required a level of formality. For example, the claimant could have said, "I withdraw my appeal";
- the claimant expressly stated she had not withdrawn her appeal as ACAS had apparently told her not to do so;
- In a gross misconduct case, the tribunal noted that an appeal might take on more significance as the employee would be keen to show that they are not guilty of gross misconduct. If they are cleared of the stigma of a gross misconduct dismissal this will obviously assist with future employment. Gross misconduct appeals need to be very clearly withdrawn;
- The employee may have said that trust and confidence had broken down but this was a case with high stakes and high emotion, and both sides may have said things they regretted. The claimant never withdrew her appeal, whatever she may have said; and
- The claimant, despite stating from January-April 2019 that she did not wish to return to work with the respondent, continued to participate in its appeal process.

As a result, the claimant's appeal continued and, when it was successful, she was reinstated. It followed that her original dismissal in January 2019 had indeed "vanished", and could not be relied upon to found any tribunal proceedings.

WHY THIS MATTERS

This case focuses on the words/actions necessary to withdraw an appeal and the EAT said that whether or not an appeal was withdrawn was a question of objectively looking at the words used.

It highlights the importance of analysing exactly what is said and when it is said. Although it was not argued, this case has parallels to those where employees, for example, resign in the heat of the moment and it is later found that these were not true resignations. In this case, however, the employee, despite what else she may have said when upset, did not say "I withdraw my appeal" and did not formally withdraw her appeal on the advice of ACAS.

It is a reminder to employers to have clear policies regarding how to withdraw an appeal to avoid ambiguity. It is also a reminder to look (or listen) carefully at/to the wording used by employees regarding the desired outcome of an appeal process, and not least to take a clear and detailed note of what is said.

The facts in this case were that only clear and express words e.g., "I withdraw my appeal" would be effective actually to withdraw an appeal. Words which may have meant to have carried the same

meaning, such as “I don’t want to work here anymore” will not constitute an express withdrawal of an appeal.

Mrs K Marangakis –v- Iceland Foods Ltd

IS IT IMPORTANT FOR EMPLOYEES TO MITIGATE THEIR LOSSES, OR AT LEAST SHOW THEY TRIED?

The claimant was dismissed in October 2017 and brought a claim for an automatically unfair dismissal for whistleblowing. She succeeded.

Following a subsequent remedies hearing, the claimant was awarded nearly £250k for losses calculated from the date of her dismissal until a date a few weeks after the liability hearing, a period of around 85 weeks.

However, it was clear at the initial remedies hearing that, from the date of her dismissal, the claimant had not attended any job interviews and generally made no effort to secure a new role. She ran two arguments in support of this:

1. The claimant said there was little point in her even trying to find another job as she would have the stigma of being a successful whistleblower who had litigated against her employer and won. Due to this she said, no employer would employ her i.e. she considered that she was likely to be prejudiced due to the reason of her dismissal. The claimant said that once the tribunal’s judgment in her favour had been published, it would take a few months to sink in but that, after that initial period, she would then be able to try and find a new job. Her reasoning was that, before the judgment was published, she would have to tell any prospective employer about the proceedings. Once the judgment was public, she would not. The Tribunal accepted this argument, but did so without any evidence that, as question of fact, the claimant would actually be stigmatised by the proceedings she had brought;

2. The claimant also said she had not looked for a job because she intended to go into business with two former colleagues, and she did not want to interfere with the activities (including networking events) connected with the new business. This was not accepted by the tribunal. The claimant had only attended one networking event in three years and had very little contact with her former colleagues.

The employer appealed. Whilst it accepted that ‘stigma compensation’ was a genuine legal argument, it argued that the tribunal had accepted the claimant’s account of events without any evidence. The tribunal in particular had failed to consider the 2010 case of ***Chagger –v- Abbey National/Santander*** (“**Chagger**”), where the claimant ran a similar argument relating to a successful claim, but provided a great deal of evidence to support his case.

The EAT agreed. The legal obligation is on the employee to take reasonable steps to mitigate their loss. The claimant in *Chagger* had applied for 111 jobs and was turned down for all 111. There was no question that Chagger had made every effort to mitigate his loss. The claimant in this case however had taken no such steps, instead making the assumption, without evidence, that employers would not consider her for a job.

WHY THIS MATTERS

For employers this case shows that the tribunals place significant importance on the obligation to mitigate. An employee who sits back and waits for compensation to be paid will be unlikely to fare well. In this case, the failure on the part of the claimant was particularly clear, but mitigation is still an important consideration in relation to both remedy and potential settlement negotiations.

Hilco Capital Limited –v-Harrington

NEWS ROUNDUP

ICO CONSULTATION ON WORKERS' HEALTH GUIDANCE

The ICO published its draft guidance on information about workers' health alongside a blog on the same subject. The guidance is open for consultation until 26 January 2023. This comes very shortly after the draft guidance regarding employee monitoring at work, covered in our last edition.

The draft guidance covers processing health data, and advice on sickness, injury and absence records, occupational health schemes, medical examinations, genetic testing and general health monitoring. The ICO is apparently planning to create a hub for guidance for both employers and workers.

ACCENT BIAS – HAVE THINGS REALLY CHANGED?

A survey published in early November by the Sutton trust found that 25% of employees in the UK have been mocked at work because of their accent, 19% feel their accent could affect their ability to succeed at work in the future and 23% feel self-conscious at work about their accent. Overall, and including outside work, 46% of employees have experienced being singled-out or mocked because of their accent.

The report recommends that employers should take action to tackle accent bias as a diversity issue. The report also suggests that employers should aim to have a range of accents represented in their organisations, that recruiters have training relating to accent bias and that there should be no implicit expectation that professionalism is linked to any particular accent.

ETHNICITY PAY AND WORKING GAP CONTINUES

Last month the Institute for Fiscal Studies (IFS) published a review showing that, although, overall, employment progression for ethnic minorities had improved since the mid-1990s, this has not translated into better pay. An ethnicity pay gap still exists and varies between different ethnic minority groups.

Differences in employment rates have improved a great deal, with most ethnic minority groups being 2-3% less likely to be in employment that white British men, compared to 30% in the mid-1990s. However, and by contrast, median weekly earnings do not show the same level of improvement. Earnings amongst Indian men were 13% higher than white British men in 2019, whereas earnings amongst Caribbean men are 13% lower. Pay for Pakistani and Bangladeshi men remain considerably lower (at 22% and 44% respectively). Employment rates were also much more varied amongst women, with Bangladeshi and Pakistani women 30% less likely to be employed than white British women.

The study made the point that there is great diversity between different ethnic minority groups and that lumping all ethnic minority groups together is unhelpful and uninformative.

This article was co-written with Trainee Solicitor-Apprentice Ellie Serridge.

RELATED CAPABILITIES

- Employment & Labor

MEET THE TEAM

Katherine Pope

London

katherine.pope@bclplaw.com
+44 (0) 20 3400 3533

David von Hagen

London

david.vonhagen@bclplaw.com
+44 (0) 20 3400 3576
