5.3 Scope of charge

5.3.1 Meaning of general earnings

Once it is established that there is an employment or office to which ITEPA 2003 applies, the next step is to consider what income will be caught by the charging provisions.

The charge to tax is limited to general earnings and specific employment income (s. 6).

"General earnings" are defined in s. 7 as:

- earnings within s. 62;
- any amount treated as earnings where agencies or employment intermediaries are involved (see **Chapter 13**);
- any amount treated as earnings under Pt. 3, Ch. 2-10 (the benefits code – see **Chapter 6**);
- any amount treated as earnings under Pt. 3, Ch. 12 (including sick pay, sporting testimonials, payment of non-deductible expenses and payments for restrictive covenants – see **5.3.3** below); and
- balancing charges treated as earnings under CAA 2001, s. 262 (see **20.4.7**).

Section 62 states that earnings in relation to employment include:

- any salary, wages or fees;
- any gratuity or other profit or incidental benefit in kind obtained by the employee if it is money or money's worth; and
- anything else that constitutes an emolument of employment.

This definition is extremely wide. Most money payments are covered, and the definition extends beyond this to encompass benefits or profits that can be said to be "money's worth". Section 62(3) assists by defining "money's worth" as something that is "capable of being converted into money or something of direct monetary value to the employee".

Clearly, any asset that is capable of being sold is capable of being converted into money. However, the case of *Heaton v Bell* emphasises that the definition goes further than that. The employee was provided with the use of a car by his employer in return for a deduction from his wages. The car could be surrendered at any time and the wages increased to their original level. Today, the car would be taxed under the benefits code (see **6.2**), and probably be treated as being part of an optional remuneration arrangement (see **6.10**). However, at that time neither of these provisions existed. The House of Lords held that the provision of the car was an emolument because it could be turned into money by surrendering it back to the employer.

Even if an asset is not involved, the definition of money's worth extends to something that is of direct monetary value to the employee. This includes payments by the employer to discharge a debt or other pecuniary liability of the employee. The idea is that by paying money owed by the employee, money is effectively freed up for the employee to spend on something else. See *Nicoll v Austin* which involved the employer paying for the employee's heating and lighting, and *Hartland v Diggines* where the employee's income tax was discharged by the employer on his behalf.

Law: ITEPA 2003, s. 7, 62

Cases: *Hartland v Diggines* (1926) 10 TC 247; *Nicoll v Austin* (1935) 19 TC 531; *Heaton v Bell* (1969) 46 TC 211

5.3.2 "Relating to the employment"

In order to be taxable, the earnings must relate to the employment.

Where earnings are provided in return for the performance of services, the position is clear enough. However, consideration has also to be given to other payments made by an employer.

In *Shilton v Wilmshurst,* a signing-on bonus paid to the former England goalkeeper, Peter Shilton, was regarded as an emolument from the employment he was about to enter into. It was held that payments for services about to be performed, or performed in the past, will be taxable as arising directly from the employment. (See **Chapter 9** for more detail on payments after employment ceases.)

Other lump sum payments, such as payments made to employees in recognition of changes made in their conditions of service or loss of rights, are also regarded as relating to the employment. This was demonstrated in *Hamblett v Godfrey*, where the employee received a payment of £1,000 in return for loss of employment protection, principally the right to join a trade union. Neill LJ took the view that the payment was referable to the employment and nothing else and, as such, was taxable as earnings.

Payments that are not from the employer, or are not lump sums, can also be regarded as earnings. In *Calvert v Wainwright*, a taxi driver employed by a taxi hire company was held to be chargeable in respect of tips he received on the basis that the sums were an ordinary and accepted way of rewarding the service received and, as such, must be received by reason of the employment.

However, there are limitations. It is not enough that the person who receives it happens to be an employee. Nor is it enough that it is paid by or on behalf of an employer. The earnings must come to the employee *because* he or she is an employee and for no other reason.

In *Laidler v Perry*, Lord Reid put succinctly the question that has to be answered in all cases:

> "Did this profit arise from the employment? The answer will be no if it arose from something else."

In *Hochstrasser v Mayes*, Lord Radcliffe said:

> "It is not sufficient to render a payment assessable that an employee would not have received it unless he had been an employee; it is assessable if it has been paid to him in return for acting as or being an employee."

Example

An independent coffee shop situated on the bottom floor of an office building decides to offer a 10% discount to all workers in the building. Janice works in the building and qualifies for the discount. Although she would not have received the benefit if she was not an employee, she is not receiving it in return for acting as or being an employee but rather because the coffee shop wants to attract custom. The discount is not taxable as employment income.

Law: ITEPA 2003, s. 7, 62

Cases: *Calvert v Wainwright* (1947) 27 TC 475; *Hochstrasser v Mayes* (1959) 38 TC 673; *Laidler v Perry* (1965) 42 TC 351; *Hamblett v Godfrey* [1987] BTC 83; *Shilton v Wilmshurst* [1991] BTC 66

5.3.3 Payments treated as "general earnings"

As mentioned above, "general earnings" also include a number of specific payments set out in ITEPA 2003.

These include payments of tax on the employee's behalf and payments while absent from work due to sickness. Details of these can be found in **Chapters 6** and **12** respectively.

Part 3, Ch. 12 also covers payments for restrictive covenants. Typical examples of restrictive covenants include employees agreeing not to approach or solicit existing customers of the employer after they leave (non-solicitation covenant) or agreeing not to work in the same industry for a period after they leave (non-competition covenant).

Payments in connection with these types of covenant are treated as general earnings if the conditions in s. 225 apply:

- a restrictive undertaking is given in connection with a current, future or past office or employment;
- the undertaking involves restrictions on conduct or activities; and
- a payment is made in respect of the giving of the undertaking or its partial or total fulfilment.

Section 225 only applies where the payment is not otherwise treated as general earnings. Therefore, a restrictive covenant contained in an employment contract would not trigger a charge under s. 225, as any payments under that employment contract are likely to be taxable already as general earnings. However, a payment made to an employee to enter into new restrictive covenants as part of a compromise agreement after termination of employment would be caught by s. 225.

It does not matter if the undertaking is absolute or qualified or whether it is legally binding or not. Furthermore, it does not matter who receives or makes the payment.

Where the payment is in the form of an asset or other valuable consideration, rather than money, the tax charge will arise on the cash value.

Law: ITEPA 2003, s. 221-226E

5.3.4 Meaning of "specific employment income"

As mentioned above, ITEPA 2003 brings specific employment income into charge as well as any general earnings. This is defined as:

- amounts charged under Pt. 6 (non-approved pension payments and payments under EFRBS – see **Chapter 31**);

- amounts charged under Pt. 7 (employment-related securities – see **Chapter 10**);
- payments treated as termination payments within s. 401, above the exemption threshold (see **Chapter 9**);
- amounts under Pt. 7A (employment income provided through third parties – see **Chapter 13**); and
- amounts which count as employment income through any other enactment.

In other words, specific employment income is income taxable under ITEPA 2003 other than general earnings. The distinction is important. Certain rules in relation to the taxation of non-UK residents and non-UK domiciles apply only to general earnings (see **Chapter 34**). Furthermore, deductible expenses relating to specific employment income can only be set off against specific employment income and deductible expenses relating to general earnings can only be set off against general earnings (see **Chapter 8**).

Law: ITEPA 2003, s. 6-7

5.4 When does the charge to income tax arise?

5.4.1 The receipts basis

Employment income is typically taxed on the “receipts” basis, as defined at s. 18. Essentially, an amount of income will be treated as received on the earliest of:

- the time when payment is made of, or on account of, the earnings (rule one);
- the time when a person becomes entitled to payment of, or on account of, the earnings (rule two); and
- if the person is a director (rule three) the earliest of:
    - the time when sums are credited in the company’s accounts or records;
    - if the amount of earnings for a period is determined by the end of the period, the time when the period ends; and
    - if the amount of earnings for a period is not determined until after the period ends, the time when the amount is determined.

Example

Archie (who is not a director) is paid a bonus on 31 May 2022 in relation to a work project he carried out in November 2021. Under the receipts basis, the bonus will be taxed on 31 May 2022.

Non-UK domiciled employees may be taxed on the remittance basis in relation to certain overseas employment duties (see **Chapter 37**).

Law: ITEPA 2003, s. 18

5.4.2 Meaning of the "date of payment" in rule one

The date of payment is the date the employee is first able to access the money for his or her own use and benefit.

There are various ways in which money can be "paid" to employees. The most straightforward is the handing over of cash. However, other common scenarios include:

- a cheque (the date of payment arises when the employer posts the cheque or hands it over to the employee; the date the cheque is cashed or put into the bank does not matter);
- a credit transfer to a bank or building society account;
- crediting an account in the employer's books on which the employee is free to draw at will (*Newsmith Stainless Ltd*); and
- paying the income to a third party or using it in some way at the employee's discretion or with his consent to a purpose of his choosing.

Earnings are also treated as received when a payment is made "on account of earnings", i.e. when the employer agrees to pay the employee money the employee has earned, but which is not yet due for payment.

Example

Suzanne is paid at the end of each month. In June 2022, she runs into financial difficulties and the employer agrees to pay her June salary on 15 June 2022, two weeks before it is normally paid. This is a payment on account of earnings and the date of receipt is 15 June 2022.

Care has to be taken not to confuse a payment on account with a loan. A payment to an employee where there is an expectation of repayment (even if that repayment is out of future salary payments) is not a payment on account of earnings. There may be a taxable benefit if the interest payable is at a low rate (see **Chapter 6**) but there will be no payment on account of earnings at the time the amount is advanced.

It is vital to look at the reality of the arrangement – just because something is described as a payment on account or a loan does not make it so. This was reinforced by Gibson J in *Williams v Todd* when he refused to regard an interest-free advance from an employer to his employee to purchase a new residence as a payment on account of earnings. He ruled that the existence of a right to repay on demand is enough to categorise the advance as a loan, regardless of what the parties called it.

A non-cash benefit is "paid" on the date it is first made available to the employee.

Law: ITEPA 2003, s. 18(1)

Cases: *Garforth v Newsmith Stainless Ltd* (1978) 52 TC 522; *Williams v Todd* [1988] BTC 315