

How to tax a settlement payment

When assessing the tax status of a settlement payment, this is the starting position:

| Payment | | Is it taxable? |
|--|--|------------------------|
| Contractual payments and earnings (including contractual PILONS) | Any payment in reward for services past, present or future. | Yes |
| Settlement of discrimination claims arising during employment (eg Mr A v HMRC) | Must be clearly unrelated to termination of employment | No |
| Compensation for injury to feelings during employment | Must be clearly unrelated to termination of employment | No |
| Settlement payments on termination of employment | Excludes contractual PILONS but may include discretionary payments in lieu of notice | First £30,000 tax free |
| Compensation for injury to feelings on termination of employment | No longer treated differently from other non-contractual termination payments | |

While this is the general position, it is important to note that there is conflicting case law and the First-tier Tax Tribunal is not bound by its previous decisions. Further, the specific facts of a given case may have a significant impact on the tax position. It is therefore worth taking advice at an early stage in negotiations to avoid reaching an agreement on tax treatment that HMRC might challenge.