Taxing discretionary gifts to employees: OOCL UK Branch v HMRC

Employment Tax

Taxing discretionary gifts to employees: OOCL UK Branch v HMRC
19 February 2024

We look at how a discretionary gift by a former company owner to its employees was taxed.

Key Points

What is the issue?

When the company OOCL was sold, Mr Tung (who ran the company) announced a discretionary payment to be made through the payroll to the 10,300 staff worldwide and funded by his family. He decided that the payments did not need to be subject to PAYE and NICs.

What does it mean for me?

HMRC argued first that the payments represented emoluments from the workers' employment, and that they represented benefits caught by ITEPA 2003 s 201.

What can I take away?

The case provides a timely reminder that the employment income rules are widely drafted and that HMRC will often seek to establish that truly gratuitous payments are indeed 'from' the employment.

A payment made by an employer to an employee will usually be subject to tax as employment income and, in the case of a cash payment, PAYE will usually be due. However, that is not an immutable rule. Indeed, although it might represent a reasonable assumption, any proper analysis needs to be more rigorous than that. The need to take a close look at the legislation and not to rely on short cuts was recognised by the First-tier Tribunal as demonstrated in its decision in *OOCL UK Branch v HMRC* [2023] UKFTT 996 (TC).

The facts of the case

OOCL is a worldwide company operating in the container ship business. It was established in 1947 and until 2018 was family-owned. The third family member (Mr Tung) to run the company was appointed in 1996. He instituted a policy of creating a loyal workforce and, for example, rewarded staff with a Rolex watch once they had reached 25 years of service.

In July 2018, the company sold its business to a third party, no doubt giving rise to a substantial gain for the Tung family. In early August 2018, Mr Tung sent an email to the company's 10,300 staff worldwide announcing a discretionary payment to be funded by him and his family. The payment was to be made at the next suitable moment and, for the UK employees, was paid through the company's September 2018 payroll.

The company took the decision that the payments did not need to be subject to PAYE and National Insurance, but HMRC disagreed.

The dispute went to the First-tier Tribunal.

The First-tier Tribunal's decision

The case was considered by Judge Amanda Brown KC and Member Shameem Akhtar.

HMRC argued first that the payments represented emoluments from the workers' employment with the company. In the alternative, HMRC contended that they represented benefits caught by the Income Tax (Earnings and Pensions) Act (ITEPA) 2003 s 201.

Emoluments 'from' employment

The first question centred on the word 'from' as found in ITEPA 2003 s 9. Was the payment 'earnings from an employment'? By reference to the email sent by Mr Tung, the tribunal noted in particular that the payment was not a reward for past, present or future service. Instead, that email suggested that the payment was truly a gift from the former shareholders.

Furthermore, the tribunal distinguished between two concepts (often known by their Latin phraseology): was each worker's employment the underlying cause of the payment or was it merely the fact but for which the payments would not have been made? For the payment to be 'from' the employment, the payment had to be in the former category; falling within the latter was insufficient.

The tribunal accepted that each payment would not have been made but for each worker's respective employment with the company (the latter concept) but it did not accept that these employments were the underlying cause of the payment (the former).

As a result, the tribunal considered that the payments were not earnings 'from' the employment.

In reaching this conclusion, the tribunal also noted that there was no contractual obligation to make the payments, and that the payments were indeed voluntary and unexpected. They were also one-off. They did not represent a top-up of contractual wages to bring them up to market level. Furthermore, the payments were funded exclusively by Mr Tung and his family out of the proceeds of the share sale.

There were factors that pointed in the other direction – notably the fact that the payment was effected through OOCL's payroll. More equivocally, the tribunal noted that the payments were about half the annual salary and more than five times the normal maximum annual bonus paid to staff. The tribunal felt that had the payments been significantly higher that would have reinforced the company's arguments but equally they were not so modest so as to undermine its position.

Overall, the tribunal was persuaded that the payments were not 'from' the employment.

Employment-related benefits

In relation to the second argument, the tribunal noted the wording of s 201 which concerned the provision of benefits ‘by reason of employment’. It decided that that this test was broader than the ‘from’ requirement in s 9 and that it caught situations such as the present, where the employment was merely a condition for a benefit to be conferred.

Thus, although the bonus was not considered to be taxable under normal principles, it amounted to an employment-related benefit taxable under s 201.

Accordingly the company’s appeal was dismissed.

Commentary

This is a decision with which I am uncomfortable, although I cannot say that the First-tier Tribunal has clearly taken the wrong course.

So far as the s 9 point is concerned, I consider that the tribunal was right to say that the payments received by the workers were not from their employment but a truly gratuitous payment by the company’s former owners. However, there is something strange in my view about that outcome being circumvented by a broad interpretation of the employment-related benefits code at s 201. There is at least an argument to suggest that the word ‘benefit’ is to be limited to non-cash benefits, so as not to overlap with what in the vast majority of cases is going to be taxable anyway.

On a related point, it seems somewhat surprising that employment-related benefits taxable under s 201 (and which will not usually be paid in cash) should be subject to PAYE, which is the implication of the First-tier Tribunal’s decision.

Indeed, since the First-tier Tribunal accepted that the true payer of the sums was the Tung family (and not the company), there is an argument that, even if subject to PAYE, the liability to operate PAYE should not have fallen on the company which was merely the conduit for the payments. (If the sums were not subject to PAYE, or at least if any PAYE obligations fell on the Tung family who made the payments, then the company’s appeal should have been allowed, even if under s 201 the payments were still taxable on the employees.)

Another area which might merit further consideration is the part of the First-tier Tribunal’s decision which considered s 201(3). That subsection contains a deeming provision very similar to that considered by the Supreme Court in the recent case of *Vermilion Holdings* [2023] UKSC 37 (see my article in *Tax Adviser*, December 2023). The relevant part of s 201(3) reads:

‘A benefit provided by an employer is to be regarded as provided by reason of employment…’

As the Supreme Court held, the deeming provision ensures that (except in cases covered by the omitted words which are not relevant to the present case) whenever a benefit is provided by an employer, one does not need to investigate the reasons for its provision; instead, such a case is deemed to satisfy the statutory requirement for the benefit to be ‘provided by reason of employment’.

However, the First-tier Tribunal agreed with a submission made by HMRC to the effect that ‘the deeming provision in ITEPA 2003 s 201(3) must carry the consequence that s 201(1) applies to benefits funded by third parties'.

It is undoubtedly the case that the deeming provision, if it applies, carries the consequences of the deeming, irrespective of the source of the funding of any benefit. However, the inference I drew from the First-tier Tribunal's decision is that it considered the deeming provision itself to bring benefits provided by third parties into the scope of the s 201 charge.

In my view, that is going too far. In the present case, I do not consider that the benefit was provided by an employer – it was provided by the Tung family who used the employer as a mere conduit. That, in my view, means that the deeming provision has no relevance. As to whether that is sufficient to overturn the First-tier Tribunal's decision, I do not know.

What to do next

Irrespective of the concerns I have raised, the case provides a timely reminder that the employment income rules are widely drafted and that HMRC will often seek to establish that truly gratuitous payments are indeed 'from' the employment. Whilst they will be right in many cases, there are always going to be exceptions, as the *OOCL* case demonstrates.

Furthermore, anyone making payments of PAYE income should take care to comply with the PAYE obligations because recovery action from HMRC at a later date will usually lead to an additional tax burden on the payer which will be hard (and sometimes impossible) to recover from the workers.