

UK Tax Round Up

December 2023

Welcome to December's edition of our UK Tax Round Up. This month has seen two interesting decisions on the connections needed for amounts to be taxed as employment income, the latest instalment in the BlueCrest partner incentivisation plan case, an attempt to use cases invented by ChatGPT as evidence, publication of the Finance Bill and the revised UK/Luxembourg double tax treaty coming into force.

UK Tax Developments

Publication of Finance Bill

Finance Bill 2023-24 was published on 29 November 2023. This includes all measures released over the summer to form part of the Bill, as well as the measures announced in the November Autumn Statement (see our [November 2023 UK Tax Round Up](#) for further details. Royal Assent for the Bill is currently scheduled for February 2024.

New UK Luxembourg Tax Treaty

We reported in our [July 2023 UK Tax Round Up](#) that both the UK and Luxembourg had ratified the new double tax agreement between the two countries. The treaty is now in force and will be effective for UK income and capital gains tax purposes from April 2024 and for withholding tax from 1 January 2024.

As a recap, some of the key changes in the treaty include the right of the UK to tax the sale of share sales by Luxembourg residents in companies that are "UK property rich", a 0% withholding tax on almost all dividends (excluding certain real estate related dividends), the recognition of certain collective investment vehicles which are treated as being companies in Luxembourg and are owned by Luxembourg residents or persons with equivalent treaty benefits as being "resident" and beneficially owning their income and the replacement of the "place of effective management" residence tie breaker with a mutual agreement procedure.

Updated HMRC guidance on overseas entity classification

On 6 December, HMRC updated the section in its *International Manual* discussing the UK tax characterisation of overseas entities, and of Delaware (and other US) limited liability companies (LLCs) in particular (in INTM180000 and INTM180050).

We have published a discussion of this revised guidance in our *TaxTalks* blog; a link to that piece is [here](#).

UK Case Law Developments

Payment to amend pension terms was “from employment”

In *E.ON UK plc v HMRC*, the Court of Appeal (CA) has reinstated the decision of the First-tier Tribunal (FTT) that a one off payment made by E.ON to employees as part of a package of changes made to their pension schemes was taxable as employment income. We reported on the FTT’s and Upper Tribunal’s (UT’s) decisions in our UK Tax Round Up in [June 2021](#) and [July 2022](#). Under the arrangement, the relevant employees agreed to changes to their future (not existing) pension rights and pension payments in consideration for a “facilitation payment” as part of an overall agreement relating to future pay increases and E.ON agreeing not to make any further changes to its pension schemes and certain other employment related commitments. The future pay increases were only available to employees who agreed to the pension changes.

The FTT had held that the facilitation payment was “from” the employment, and so taxable as employment income under section 9(2) ITEPA, because it related to changes to future rights linked to employment and was part of a package that included the future pay increase. The FTT’s decision was based largely on its interpretation of the decision in the *Tilley* case and that the exception from treating payments for changes to contractual rights of employees as being “from” employment extended only to accrued rights and not future and/or contingent rights.

That decision was overturned by the UT, which decided that the FTT had been wrong in law to limit the *Tilley* decision in this way and that the requirement was to assess, on the facts and circumstances, whether the payment in question was from the employment or from something else. In addition, while it might be relevant to an assessment of the facts that the facilitation payment was part of a package including increase in future pay, there was a requirement to consider the source of each individual element of the package and the FTT had also been wrong in deciding that the facilitation payment was from employment because it was part of the package including an increase in future salary. Having decided that the FTT had applied the law incorrectly in coming to its decision, it stated that the *Tilley* decision could extend to changes to future rights and that the facilitation payment was derived from the changes to those rights and not from the employment itself.

In this latest judgment, the CA has reversed the UT's decision and agreed with the FTT that the facilitation payment was "from" the employment and thus subject to tax as "earnings". In a reasoned examination of the case law, the CA found no error was made by the FTT and endorsed its approach to the sort of connection with employment that will result in payments being "from" the employment.

The UT's decision was seen by many as an outlier, so the restoration of the initial decision by the CA comes as no surprise to many tax commentators. It is hard to see the fundamental distinction between a payment to induce an employee to accept changes to their general terms and conditions of employment and one to accept a change to the terms and conditions of their pension while they are still employees when considering the question of whether or not a payment derives "from" the employment.

Payments made by former chairman to employees subject to employment tax

In *OOCL UK Branch v HMRC*, the FTT has held that certain payments made by Mr Tung, the former majority shareholder and chairman of Orient Overseas Container Line Limited (UK Branch) (OOCL), following its sale were benefits provided "by reason of employment" and subject to tax as earnings under section 201 ITEPA.

OOCL is an international container shipping company which was founded and owned by the Tung family for several decades. In 1996 Mr CC Tung took over as chairman and majority shareholder of OOCL. On 24 July 2018, Mr CC Tung sold his interest in the company. On 3 August 2018, he resigned as a director of OOCL. On 2 August, Mr Tung wrote to the OOCL workforce in the following terms:

“As we move toward the close and I will step down from my role as Chairman after 22 years, the Tung family wishes to express its appreciation for the long corporate journey we have had together by making a special discretionary payment to colleagues directly employed by OOIL and its subsidiaries, according to certain terms and conditions. Whether through good or challenging times, it is you, our people, united as a team under the OOIL banner and the “Take it Personally” spirit, who have continued to deliver. This special discretionary payment will be funded by the Tung family, and distributed through OOIL, as payment agent, as a bonus. Details of this special discretionary payment by the Tung family will be further communicated through CADM.”

The payments were made and, in accordance with his intention to bear the full cost of the payments, Mr Tung paid OOCL the full gross value of the payments and the employer’s national insurance contributions (NICs). The payments were then made by OOCL through its payroll and subject to deductions for PAYE and employee NICs.

Sometime shortly after the payments were made, the OOCL finance team reviewed their tax treatment. The team concluded that the payments were not emoluments “from” employment for the purposes of section 62 ITEPA and were not “paid by reason of” employment for the purposes of section 201 such that they should not have been paid subject to PAYE or NICs. OOCL raised this at a meeting with HMRC and contended that the payments were a simple gratuitous act of generosity by Mr Tung.

HMRC disagreed and contended that the payments were made as a consequence of the recipients being employees and having contributed to the success of the business over the year which justified the significant value of OOCL which benefited Mr Tung. HMRC placed significant reliance on the correlation between length of service and salary on the one hand and the amount of each payment on the other, that the payments were only made to individuals who were OOCL employees at the time of the sale together with the language used in the Mr Tung's email to the staff reflecting that the payments were paid in recognition of past service and the anticipated expectation of continued contribution to the success of OOCL in new hands and under new senior management.

The FTT found, as a matter of fact, that Mr Tung had indeed made the payments as a mark of appreciation to the UK workforce (as part of a gesture of similar appreciation to the global workforce) following the successful sale of the business and in consequence of his long tenure as both chairman and majority shareholder. He did so as a personal gesture of thanks from the proceeds of sale. However, the FTT also found that the payments were made by virtue of the recipients' status as employees and so "by reason of employment".

In coming to its decision, the FTT discussed the recent conclusions of the Supreme Court (SC) in the *Vermilion* case (discussed in the October 2023 edition of our [UK Tax Round Up](#)) and the CA's decision in *John Charman v HMRC*. In *Charman*, the CA confirmed that the correct test to be applied to determine whether a sum is received "by reason of employment" does not require that the sum be received only by reason of employment but, rather, by asking what enables the person to enjoy the benefit (so, what is the operative reason). In that case, the CA found that that the taxpayer had, following a share for share exchange, acquired his interest in the replacement restricted shares "as a director or employee" such that the shares were "employment related securities" acquired "by reason of employment".

The FTT concluded that the only relationship of substance or relevance between Mr Tung and the recipients collectively was that he was the chairman and majority shareholder of their employer and that they were all employees. These factors were found by the FTT to be conclusive that employment was a cause of the payments being made. The fact that the FTT found that the payments represented a mark of appreciation and were entirely funded by Mr Tung did not preclude a conclusion that the payments were made "by reason of employment" for the purposes of section 201 ITEPA.

This outcome of this case is not wholly surprising but is noteworthy as it joins a recent line of cases focusing on the connection between employment and the receipt of payments and highlighting that any material connection between a payment and the recipient's status as an employee is likely to result in employment tax being due on the payment.

Case dismissed where taxpayer used ChatGPT to find supporting case law

In *Harber v HMRC*, the FTT dismissed Mrs Harber's appeal against an HMRC imposed penalty for failing to notify a liability to capital gains tax (CGT) after disposing of a property. Mrs Harber had appealed the penalty on the basis that she had a reasonable excuse due to mental health and/or because it was reasonable of her to be ignorant of the law. Although it was accepted that Mrs Harber did have mental health problems arising from being the sole carer to her mother and that she was not fully aware on how CGT worked, on examining the law on reasonable excuse and Mrs Harber's actions (such as putting money aside in case HMRC assessed her for tax), the FTT held that Mrs Harber could not claim that she had any reasonable excuse with respect to the CGT liability.

Mrs Harber had sold a property she had owned and, although she did not receive advice from her solicitors that she might be liable to CGT on disposing the property, she put some money aside which she invested in UK gilts as she thought she might owe HMRC some money. She did not seek tax advice until after HMRC found out that she was receiving rental income and began a formal assessment of her tax liability. After assessing her CGT liability for the sale of the property (which she did not dispute), HMRC issued a penalty for late payment of the CGT.

To support her arguments against the penalty, Mrs Harber provided the FTT with names, dates and summaries of nine other FTT decisions in which the appellant had been successful in claiming that they had a reasonable excuse. Unfortunately, none of these decisions were genuine. The FTT found, as a matter of fact, that the case summaries had been produced using artificial intelligence (AI) software (ChatGPT). It was also accepted that Mrs Harber had been unaware that the cases were not genuine and that she did not know how to check their validity by using the FTT website or other legal sources.

Both HMRC's counsel and the FTT attempted to find the cases cited but failed to do so. Mrs Harber admitted that she might have used ChatGPT to generate them but in any event, this did not matter as she was sure that the FTT had decided that a person's ignorance and/or mental health could provide a reasonable excuse against penalties. Interestingly, Mrs Harber asked how the FTT could be confident that the cases that HMRC relied on and included in their court bundle were genuine. The FTT explained that HMRC had provided a full copy of each judgement and that each case was published on publicly accessible websites. Mrs Harber had not been aware of these sources.

The FTT also addressed the use of artificial intelligence in legal research and made the point that citing invented cases can be problematic because it wastes the FTT's and HMRC's time and public money and reduces the resources available to progress the cases of other court users. The FTT cited the similar recent American case of *Mata v Avianca* in which two advocates had relied on ChatGPT to produce supporting case law, which were found not to be genuine. The judge in that case not only cited a waste of resources but stated that such actions promoted "cynicism" about the legal profession and the judicial system.

This is an interesting case highlighting one of the more unexpected consequences of AI and how wary courts might have to become about case and other citations put to them as part of future cases.

BlueCrest partner incentivisation plan payments taxed as miscellaneous income

In *BlueCrest Capital Management LP and others v HMRC*, the CA has upheld the decision of the UT, and the FTT before it, that certain payments received by individual members of BlueCrest were subject to income tax under section 687 ITTOIA as miscellaneous income not otherwise charged.

We discussed the UT's decision in the case in our August 2022 edition of [UK Tax Round Up](#). The case involves a "partner incentivisation plan" (PIP) arrangement that was put in place by BlueCrest as a method of retaining and incentivising certain members of the business. The PIP was used by three different BlueCrest entities through which its UK investment management business was run, each of which was a partnership for UK tax purposes.

The summary facts of the case were that BlueCrest added a corporate member to each partnership. Amounts of partnership profit that would otherwise have been paid to the members as annual profit shares (or bonuses) was instead paid to the corporate member. The corporate member paid corporation tax on the profits and contributed the remainder back to the partnership as “special capital”. The partnership invested the special capital into units in funds managed by BlueCrest. Following a remuneration committee process, recommendations were made to the corporate member (or the independent body that represented it) that the corporate member should transfer certain of the special capital units to individual members of the partnership. Following any such allocation, the individual member could call for the relevant fund units to be distributed to them. The expectation was that the corporate member would pay corporation tax on the profits allocated to it but that the individual members would not pay further tax on the special capital units allocated and distributed to them because that was just a transfer of partnership capital. The post tax amount received by the individual members was, therefore, more than they would have retained had they received the partnership profits directly. It was asserted by BlueCrest, and accepted by the courts, that the PIP had a commercial purpose of retaining and incentivising staff and also allowed BlueCrest to defer payment of performance linked amounts to the individuals and effectively claw back amounts if, for instance, funds managed by them made a profit in one year and a loss the next.

HMRC raised assessments on certain individual members who benefited under the PIP. HMRC argued in the alternative that:

1. the partnership profits allocated to the corporate member and then the individuals through the PIP and special capital should be treated as profits of the individuals under section 850 ITTOIA applying a realistic approach to the people who were entitled to the profits under the partnership’s profit sharing arrangements;
2. the amounts received by the individuals on allocation to them of the special capital and receipt of any proceeds from it were subject to income tax under section 687 ITTOIA as miscellaneous income not otherwise charged; or
3. the amounts received by the individuals was subject to income tax under Chapter 4 Part 13 ITA as receipts from the sale of occupational income.

The CA agreed with the FTT and UT that section 850 ITTOIA did not operate so as to treat the individuals as the people entitled to the partnership's profits under its profit sharing arrangement by reason of the allocation of the special capital to them. Section 850 was a clear provision that gave effect to the way in which partnership profits were taxed and, in this case, the corporate member was a member of the partnership and the partnership's profit sharing arrangement allocated the relevant profit to it with the resulting tax consequences that it was subject to corporation tax on them. In addition, it was not the case that all of the profit allocated to the corporate member ended up in the hands of the individuals (the corporate member had costs) and the individuals had no rights in respect of the profits unless and until it was contributed to the partnership as special capital and then allocated to the members. There was a significant minority of cases in which special capital allocated to members was reversed before the members benefited from it as a result of certain clawback rules in the PIP. The CA rejected comparisons with the "diverted earnings" approach to certain employee benefit trust and employment tax arrangements exemplified by the *Rangers* case on the basis that it was not appropriate to try to make such a comparison across two completely different sets of taxing provisions and that the terms of section 850 and the taxation of partnership profits was completely different to the employment tax regime.

The CA then considered the position under section 687 ITTOIA. It was accepted that, in order for section 687 to apply to amounts received by the individuals (or the allocation of the special capital to them), it was required that, firstly, the special capital allocation was "income" by reference by analogy to a type of income subject to tax other any of the other heads of income subject to tax under the income tax acts and, secondly, that a "source" could be identified for the income received by the individuals.

The CA agreed, in reasonably short terms, with the UT's decision on these points. The allocation of special capital was recurrent, an indicator that it was of an income rather than a capital nature, and was analogous to the payment of an employment bonus that would be subject to income tax under the old rules in Schedule E and now under ITEPA. The "source" of the payment was the decision by the corporate member to allocate the special capital to the individuals and that was sufficient in circumstances where, as here, the individuals had an expectation that allocations would be made to them and the corporate member was under a general duty to act in good faith when considering recommendations for allocations. Interestingly, the CA also stated that the question of whether an item was income or capital was a question of law rather than a question of fact or mixed question of fact and law.

The case provides an interesting summary of how amounts can be assessed as miscellaneous income and the factors that need to be identified to do so, and also shows how the potential breadth of the miscellaneous income tax charge can be used by HMRC to defeat this sort of arrangement which seeks to convert income into capital or some other form of lower taxed receipt.

[Related Professionals](#)

- **Robert Gaut**
Partner
- **Richard Miller**
Partner
- **Frazer Money**
Partner
- **Catherine Sear**
Partner