Employer's deductions for holiday fund breached National Minimum Wage law

By Mathew Gullick KC
3PB Barristers

Introduction

The Employment Appeal Tribunal's decision in *HMRC v Lees of Scotland Ltd* [2024] EAT 120 is another reminder to employers that the focus of the National Minimum Wage (NMW) legislation is on each worker actually receiving (subject to very limited types of permissible deductions) at least the required level of hourly pay for the work they have done. Even the most benevolent employers can breach the requirements of the NMW legislation when they deduct money from their workers' pay, if the amount retained by the employer causes the rate that is actually received by the worker to fall below the level of the NMW.

The NMW is the legal minimum rate of pay, per hour worked, across a particular period of time (referred to in the legislation as the 'pay reference period'). The essence of the NMW is the calculation of whether at least the prescribed level of NMW has been paid for a particular pay reference period. That is done by dividing the pay which a worker has received by the number of hours they have worked. If the result of this calculation is lower than the applicable rate of the NMW, then there will have been an underpayment.

There are detailed provisions in National Minimum Wage Regulations 2015 as to what does, and what does not, count as reckonable pay for the purposes of the NMW calculation – the purpose being to ensure that workers actually receive at least the rate of NMW and that unscrupulous employers do not underpay their workers by notionally paying them at or above the level of the NMW but then making unwarranted deductions from the pay which is ultimately received by the worker.

In particular, under Regulation 12, sums from workers' pay which are deducted from the pay actually received by the worker and retained "*for the employer's own use and benefit*" do not (subject to limited exceptions, such as recovering accidental past overpayments of wages) count as reckonable pay for NMW purposes – so resulting in a corresponding reduction of the rate of pay that is arrived under the NW calculation.

If, once that calculation is performed, a worker is paid less than the prescribed rate of the NMW in a particular pay reference period, then Regulation 17 provides that the worker has a contractual entitlement to be paid the arrears of NMW.

The NMW legislation is enforced by HM Revenue & Customs (HMRC) which has the power to inspect employers' records and can issue a Notice of Underpayment to an employer, requiring it to pay arrears of NMW to its workers. The employer has a right of appeal to an Employment Tribunal against such a Notice.

Facts

The employer is a well-known Scottish confectionery manufacturer. For 30 years, it had operated a holiday fund. This was entirely voluntary and enabled its workers to choose to have sums deducted from their wages and paid into the fund – although in reality there was no separate fund as such, and the money was paid into the employer's main trading account. The workers could request that their contributions to the holiday fund be returned to them. The employer complied with such requests. There was no suggestion that the intention behind this scheme was anything other than benign; its purpose was to provide a benefit to the workers and to assist those who felt they otherwise were not able to save enough money throughout the year.

In some cases, the deductions made from workers' wages in order to contribute to the holiday fund meant that the amount which they received fell below the level of the NMW – that is, the rate of hourly pay they received for the relevant pay reference period (excluding the contributions made to the holiday fund) was lower than the specified minimum hourly rate of NMW.

The employer was audited by HMRC. It took the view that the employer was in breach of the NMW legislation, because deductions that were made for the holiday fund did not count as pay for the purposes of calculating whether the level of NMW was being paid. It issued a Notice of Underpayment to the employer, which appealed to the Employment Tribunal (ET).

The issue was therefore whether the contributions made to the holiday fund counted as reckonable pay for the purposes of calculating the workers' hourly rate for NMW purposes. If these sums were to be counted as reckonable pay, then there would have been no underpayment. If the sums were not to be counted, then there would have been an underpayment.

The Employment Tribunal's decision

The ET allowed the employer's appeal against the Notice of Underpayment. It held that the sums retained by the employer as contributions to the holiday fund were not retained for the employer's "*own use and benefit*", and so there had not been an underpayment of NMW.

Alternatively, if the ET were wrong about that (and so there had been an underpayment of NMW) then its view was that payments made to the workers out of the holiday fund amounted to additional remuneration which, under Regulation 17, went towards extinguishing the employer's liability to pay the arrears of NMW. There would, in those circumstances, need to be a remedy hearing to calculate the extent to which there was any remaining liability on the part of the employer to the workers in question. But as the appeal fell to be allowed on the first issue, this was not necessary.

HMRC appealed to the Employment Appeal Tribunal (EAT) against both parts of the ET's decision.

The Employment Appeal Tribunal's Decision

The EAT allowed HMRC's appeal on both issues.

Issue 1

The EAT held that the ET had been wrong to find that, in the circumstances of this case, the deductions made were not for the employer's "*own use and benefit*". Whether a deduction is for the employer's "*own use and benefit*" is not to be considered by reference to the purpose or intention of the deduction, but by reference to the effect of the deduction on the employer's position. Can the employer use the money paid or deducted?

In the present case, the EAT held that the ET had gone wrong in focusing on the purpose and intention of the deductions (which, in the case of this employer, was entirely laudable), rather than considering whether the employer could itself use the money that had been deducted. On the facts of this case, it could. Contrary to the ET's finding, the money deducted for the holiday fund was not "*effectively ringfenced*". It was put into the employer's own bank account and was at risk in the event of the employer's insolvency; the employer even earned interest on the money. The existence of a contractual obligation to repay the money to the workers on demand, or the possibility of the money being held on trust for the workers, did not mean that the deductions were not for the employer's "*own use and benefit*".

This was to be contrasted with the position where an employer made such deductions from its workers' pay but put the money into a bank account operated by a third party, such as a savings scheme provider. Such a deduction would not be for the employer's "*own use and benefit*" because there would, in the EAT's view, have been "*a full and effective alienation of the funds, usually achieved by entering into an arrangement with a scheme provider.*"

Issue 2

The EAT held that the ET had also been wrong to find that payments out from the holiday fund counted as deferred remuneration which could be taken into account when determining the outstanding level of arrears of NMW. There was no link between the payments made to the workers out of the holiday fund and any particular pay reference period – it was therefore impossible to describe those payments as additional remuneration in respect of pay reference periods where, as a result of deductions made for the holiday fund, less than the rate of NMW had been paid.

The ultimate outcome, as the EAT expressly recognised, was that the employer was liable to pay its workers the relevant sums twice because of the provision of the legislation creating a contractual entitlement to payment of arrears of NMW. However, the EAT held that "*the possibility of an unintended windfall in this case should not distract the courts and tribunals from outcomes that properly secure the NMW for the lowest paid and most vulnerable workers across all parts of society.*"

Analysis

This is the latest in a line of cases in which the EAT and the Court of Appeal have made clear that the NMW legislation is to be interpreted both straightforwardly and purposively, with the aim of securing the rights of workers (many of whom will be in a far more vulnerable position and have more unscrupulous employers than in the present case).

The employer's position in this case appears to have been somewhat better than that of the employers in *Leisure Employment Services Ltd v HMRC* [2007] ICR 1056 (fortnightly charges of £6 for heat and light in accommodation provided by the employer were held to be deductions for the employer's "*own use and benefit*") and *HMRC v Middlesbrough Football and Athletic Co (1986) Ltd* [2020] ICR 1404 (deductions made from workers' pay for the purchase of season tickets to the club's football matches were held to be for the employer's "*own use and benefit*"). That is because the arrangement in *Lees of Scotland Ltd* did not, on any view, relate to the purchase of goods or services. In effect, the employer was simply holding its workers'

money on their behalf, pending demands from the workers to be given back the money to pay for their holidays.

Nonetheless, the EAT held that these arguments were not sufficient to defeat HMRC's case that the deductions were for the employer's "*own use and benefit*". The crucial issue, in the EAT's view, was the way in which the money was held. As HMRC had accepted, if the money had been put into a savings scheme operated by a third party (rather than the employer's own bank account) then the sums deducted would have formed part of reckonable pay for NMW calculation purposes and there would have been no underpayment of NMW. The EAT commented that there are "*numerous such schemes available to employers in the marketplace*". As the judicial headnote to the EAT's decision states, however, "*because the deductions were held in the company's main trading account, they were at its disposal and were for its use and benefit.*"

The EAT was dismissive of the employer's argument based on a contractual obligation to return the money to the workers on demand, or the sums being held on trust in favour of the workers. The EAT also declined to follow an *obiter* comment made by Buxton LJ in the *Leisure Employment Services* case that, in the case of a savings scheme run by an employer, it would be retaining money for the worker's "*use and benefit*" rather than its own.

There was however no suggestion that, in the present case, the obligation on the part of the employer to return the money to its workers when they asked for it was any sort of sham. Can it therefore be said, on these facts, that the money was being held by the employer "*for the employer's own… benefit*", even if the funds were available to the employer to use? It will be interesting to see whether the employer seeks to appeal the EAT's decision to the Court of Session on this basis, relying on the *obiter* view of Buxton LJ about savings schemes which the EAT declined to follow.

For now, however, the EAT's decision on the first issue in this appeal – which is to the effect that it is the fact that funds are held by the employer and are at its disposal that is crucial – will presumably be applied by HMRC and will be binding on Employment Tribunals. Employers will need to consider carefully whether any similar arrangements which they adopt and which might affect the NMW calculation should be adjusted (for example, by using schemes administered by third parties, as the EAT's judgment suggests) to take account of this decision.

On the second issue, the EAT's decision is to the effect that when subsequent payments made to workers are said to constitute additional remuneration amounting to payment of arrears of

NMW, there needs to be a sufficient link between the payments made and a particular pay reference period in which there has been an underpayment of NMW. In the present case, the sums paid out from the holiday fund were, unsurprisingly, not paid out by reference back to any particular periods of time in which they had originally been earned, and so the employer's argument that they went to extinguish its liability to pay the arrears of NMW failed. Employers wishing to rely on payments as extinguishing such liability will need to bear the EAT's view that there must be a "*link between a payment and a pay reference period*" in this respect.

10 August 2024

Mathew Gullick KC

Barrister
3PB Barristers

0330 332 2633
mathew.gullick@3pb.co.uk

3pb.co.uk