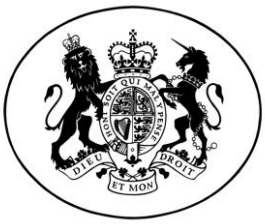
[2019] UKFTT 230 (TC)



TC07077

Appeal number: TC/2017/07716

PAYE and NIC – s 471 of ITEPA 2003 – the grant of a share option – whether Parliamentary material to be admitted following* Pepper v Hart *– statutory construction of the deeming provision under subsection (3) – whether the option is 'made available' by the employer – whether the option thereby deemed as made available 'by reason of' employment – anomaly arising where a finding of fact contrary to the deeming effect – whether limitation of deeming provision by statutory construction – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

VERMILION HOLDINGS LIMITED **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE HEIDI POON

Sitting in public at George House, Edinburgh on 19 September 2018

Philip Simpson QC, instructed by French Duncan LLP for the Appellant

Alan Waters, Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The appeal is against HMRC's decision of 17 August 2017 to assess Vermilion Holdings Limited ('Vermilion' or 'the Company') for income tax under PAYE and Class 1 National Insurance Contributions in relation to a share option exercised by Mr Marcus Noble in the tax year 2016-17.

2. The PAYE in the sum of £285,148.76 is assessed under Regulation 80 of the Income Tax (Pay as You Earn) Regulations 2003 ('Regulation 80 Determination').

3. The NIC in the sum of £100,709.98 is assessed under s 8 of the Social Security Contributions (Transfer of Function etc.) Act 1999; ('Section 8 Decision').

4. Whilst Vermilion is the 'Appellant' in this appeal, it has an indemnity against Mr Noble for any tax consequences in the event of the exercise of the share option. It is therefore Mr Noble who has a direct interest in the outcome of this appeal.

Issue for determination

5. The issue for determination is whether Mr Noble's share option falls within the provisions of s 471 of the Income Tax (Earnings and Pensions) Act 2003 ('ITEPA') to be treated as an employment-related securities ('ERS') option for tax purposes.

6. The quantum of the Regulation 80 Determination and the Section 8 Decision is not in dispute.

Evidence

7. Mr Noble and Mr Keven McDonald were called as witnesses for the appellant. I find both to be credible and reliable, and adopt their evidence as to matters of fact.

8. The parties produced a joint bundle of documents. With HMRC's agreement, three further documents (A1 to A3) were produced for the appellant and admitted at the start of the hearing. Shareholders' Agreements and Articles of Association for the relevant periods (documents B1 to B3) were produced in the course of the hearing in response to questions from the Tribunal.

The relevant law

9. The legislation applicable to this appeal is under Part 7 of ITEPA for 'Employment Income: Income and Exemptions Relating to Securities', of which Chapter 5 relates to 'Securities Options'. The key section for the purposes of this appeal is under s 471, which provides as follows:

> **'471 Share options to which this Chapter applies**
>
> (1) This Chapter applies to a securities option acquired by a person where the right or opportunity to acquire the securities option is available by reason of an employment of that person or any other person.

(2) For the purposes of subsection (1) "employment" includes a former or prospective employment.

(3) A right or opportunity to acquire a securities option made available by a person's employer, or a person connected with a person's employer, is to be regarded for the purposes of subsection (1) as available by reason of an employment of that person unless –

(a) the person by whom the right or opportunity is made available is an individual, and

(b) the right or opportunity is made available in the normal course of the domestic, family or personal relationships of that person.

(4) …

(5) In this Chapter–

"the acquisition", in relation to an employment related securities option, means the acquisition of the employment-related securities option pursuant to the rights or opportunity available by reason of the employment.

"the employment" means the employment by reason of which the right or opportunity to acquire the employment-related securities option is available ("the employee" and "the employer" being construed accordingly), and

"employment-related securities option" means a securities option to which this chapter applies.'

10. The Annex sets out other sections of Chapter 5 to Part 7 of ITEPA, together with the citation references of the authorities referred to in this Decision.

The facts

11. From the oral evidence of Mr Noble and Mr McDonald, and their respective witness statements, and from the documents included in the bundle and produced in the course of the hearing as outlined earlier, I make the following findings of fact.

History of Vermilion

12. The business of Vermilion was incorporated as 'Vermilion Software Limited' in 2003 with its office based in London. Its founders were four senior software engineers, who had worked for some time for a leading investment bank in London.

13. The business was involved in the marketing and implementation of its principal product known as 'VRS': an end-to-end client reporting solution for the fund management sector. Mr Noble referred to the unique selling point of VRS as 'shortening the time gap between data capture and production of the report'. Apart from software development, the Company's business included the sale, support, and servicing of its software product to the global asset management industry.

14. In 2006, an exercise to raise equity funding for the Company took place. According to Mr McDonald, 'the new investors wished to invest into a clean new company without legacy concerns'. Vermilion Holdings Limited (the appellant) was incorporated and registered in Scotland as the entity into which the new investments

raised in 2006 (and 2007) were made. A share for share exchange took place as part of the 2006 funding exercise to superimpose Vermilion Holdings Limited as the holding company of Vermilion Software Limited.

15. In November 2016, the business of Vermilion was sold to FactSet, a US-listed company which sells products and services into the global asset management industry.

The witnesses

16. Mr Noble described his profession as a 'corporate advisory M&A and technology business specialist'; (M&A stands for 'merger and acquisition'). His specialism is in technology businesses. He has been advising clients for over 30 years on fundraising, business growth, acquisitions and divestments. He often works alongside management as a Director *cum* Investor.

17. Mr McDonald was a corporate law partner at Dickson Minto, WS for 30 years until he retired on 30 April 2015. He advised primarily clients engaged in corporate mergers, acquisitions, disposals, and equity-and-debt raising transactions.

18. Around 1999, Mr Noble was introduced by a firm of solicitors to Mr McDonald as an adviser with particular expertise on software and IT businesses. Subsequent to that introduction, Mr McDonald and Mr Noble had worked together on a number of equity-and-debt financing and other corporate transactions.

The witnesses' involvement with Vermilion

19. In 2005, Mr Iestyn Williams, who was one of the original founders of Serco, met the founders of Vermilion and considered Vermilion an investment opportunity.

20. Mr Williams then approached Mr Noble in relation to Vermilion. At that point in time, Vermilion was significantly under-capitalised; trading was poor. Selling to large global enterprises meant that the sales cycle was lengthy, and with significant barriers. As a small company selling to large corporate organisations, the management team lacked the expertise to grow and develop the business. It was recognised that Vermilion needed additional capital, the management team strengthened, and the sales process professionalised.

21. An equity raising exercise in 2006 ensued after the discussions between Mr Williams and Mr Noble. Due diligence into the financial and legal aspects of Vermilion Software Limited was a prerequisite for the equity raising exercise, and for approaching credible investors. To that end, and through Mr Noble:

(1) Dickon Minto was brought in to act as the legal advisers; and

(2) Quest Advantage Limited, (formerly Quest Consulting Group Limited) ('Quest') was brought in to produce a business plan and financial projection.

Quest was a corporate advisory and consulting business owned by Mr Noble and Mr Scott Carnegie, who is a Scottish chartered accountant and business adviser.

Shareholdings after the financing exercise in 2006

22. According to Mr Noble, the exercise in 2006 raised investment capital around £2.5m. The shareholders after the financing exercise fell into three groups:

(1) Shareholder directors: 4 in total, each holding 1.5m A Shares and 42,500 C Shares; together they held the controlling interest of 55% equity; they received a salary for developing the software.

(2) Private equity investors: 8 in total: (a) 3 of the investors held A Shares and various combinations of B and C Shares; (b) 5 of these investors held B and C Shares only; they included the Scottish Enterprise, Mr Noble and Dickson Minto (through their respective nominee companies);

(3) The Consortium investors: 5 in total; including Sir Fraser Morrison and his family members and trust, and Mr Williams; they held B and C Shares.

23. Mr Noble informed the Tribunal that the 'outside' investors (ie other than the four shareholder directors) did not hold a controlling interest in the Company; their equity totalled 45% only.

The grant of two Supplier Options

24. Dickson Minto had provided fee quotations to Vermilion. According to Mr McDonald, the work involved was ultimately significantly greater than was originally anticipated at the outset. However, the incoming investors had approved the budget for the refinancing process and did not wish funds which were required for the development of the Company's business to be applied in meeting an overrun on legal and other advisory fees.

25. In these circumstances, the 'Supplier Options' were granted to 22 Nominee Limited (Dickson Minto's nominee) and Quest, as explained by Mr McDonald:

> 'These supplier options recognised that significant additional work had been done which was not being paid for by the Company at the time. The supplier options which were put in place in 2006 were effectively payment for services which had been provided in the process of the fundraising exercise, which terminated in a successful financing being closed out on 1 February 2006.'

The 2006 Option granted to Quest

26. It was understood that Quest and Dickson Minto would not be paid a fee for their services rendered in connection with the 2006 financing exercise. In return, the parties were agreed on an option package of 2.5% each of the equity in Vermilion after the financing exercise.

27. The Option Agreement of 2006 between Vermilion and Quest was entitled as: '*Option over Ordinary Shares representing up to 2.5% of equity*'. The agreement was signed by a Mr Osborne, one of the shareholder directors of Vermilion, and by Mr Noble as director of Quest on 1 February 2006. The signatures were witnessed.

28. The share register at the date of the grant of the Option was stated as:

> '(A) The Company has, at the date hereof, an authorised share capital of £100,813.79 divided into 7,813,069 A ordinary shares of £0.01 each

("A Shares"), and 2,268,310 B ordinary shares of £0.01 each ("B Shares") of which those shares specified in the Appendix have been or are shortly to be issued at par fully paid up.

(B) The parties have agreed that the Optionholder shall be granted an option to subscribe for shares in the Company.'

29. Clause 1 of the agreement is concerned with 'Definitions and Interpretation', wherein 'Controlling Interest' and 'Supplier Option' are defined as follows, (with each supplier option being cross-referenced to the other):

> '"Controlling Interest" means shares representing not less than 50% of the rights (as if the Option, the Supplier Option and the Haworth option had all been exercised) to receive notice of, attend …, speak … at and vote … at general meetings of the Company.
>
> […]
>
> "Supplier Option" means the option up to 2.5 per cent of the share capital of the Company to be granted to 22 Nominees Limited and in any case any share issues under such option arrangement.'

30. The terms for the grant of the subscription option are set out in Section 2 of the agreement, which reads as follows:

> '2.1 The Company hereby grants to the Option holder an option (the "Option") to subscribe at nominal value for, subject to Clause 6, such number of Ordinary Shares as represent the Relevant Percentage (up to a maximum of 2.5 per cent) as herein defined of the issued equity share capital (as defined in section 744 of the Act) of the Company as enlarged by any Permitted Issues/Options and the Supplier Option but before any variation of share capital permitted in accordance with this Agreement (the "Option Shares").
>
> 2.2 No consideration shall be payable for the grant of the Option.'

31. Clause 4 provides for the 'Exercise of Option' as follows:

> '4.1 The Option may only be exercised in whole (and not in part).
>
> […]
>
> 4.3 The Option may not be exercised more than 10 years after the date of this Agreement. …'

32. Clause 6 of the agreement concerns 'Variation of Share Capital', and states, *inter alia*, the following:

> '6.1 The Company hereby undertakes … to the Optionholder to procure so far as possible … except … (ii) where further equity shares are issued by the Company and are paid up at a fair market value evidence by a valuation report from the Company's auditors where agreement thereto cannot be reached between the parties hereto and/or (iii) where the Optionholder is first offered equivalent rights in respect of the Option Shares (as if the Option had been exercised in full before the date of the relevant issue) on a pro rata basis to the other Shareholders in respect of their interests in the capital of the Company.
>
> 6.2 It is acknowledged by the parties that the Optionholder enjoys the benefit of this Clause 6 to enable it to preserve the economic benefit of the Option and may require … the number of shares which are then the

> subject of the Option and/or the subscription price for each such share to be adjusted in such manner as shall place the Optionholder in the same position as regards (a) the percentage of the equity share capital of the Company which the Optionholder shall be entitled to acquire pursuant to any exercise of the Option …'

Background to the rescue funding exercise in 2007

33. After the 2006 equity raising exercise, the Company's performance was monitored by the new investors against the business plan which had been agreed. By December 2006, it became clear that Vermilion was in financial difficulty, and the Company was significantly under-performing.

34. Mr Williams, as one of the Consortium investors, took the lead in initiating remedial actions. The first step Mr Williams took would seem to discuss the matter with Mr Noble, and to ask Mr Noble to give a fair assessment of the situation.

35. The situation, as it stood in January 2007, was that working capital was running out and no revenue was coming in. Mr Noble assessed the prospect of Vermilion as 'the technology was very good', but 'concerned with the management approach in running the business', such as outsourcing 90% of the software development to India; that the Company had 'over-spent by a long way'; that 'going forward was to bring software development in house'.

36. Mr Noble continued in his evidence by stating that the 'bad news' in January 2007 was that 'the Company was going to go bust'; it was decided that management and administration would all 'take a bath'; that 'everyone is to get diluted' including the Options granted in 2006 to Quest and 22 Nominee Ltd. It was apparent that further injection of new capital, as well as changes in management leadership, were required to rescue the Company.

The plan to re-finance in February 2007

37. The material aspects of a two-page document (A1) that served as the blueprint of the rescue package are the following:

(1) Two existing investors, Teasses Capital Limited ('TCL') and Mr Iestyn Williams ('IW'), would each provide £100,000 of funding by way of a convertible loan note to bridge the interim shortage in working capital, and underwrite the new equity requirement of £700,000.

(2) The pre-conditions to the £200,000 convertible loan stock concerned changes to the existing management team and their remuneration packages.

(3) With effect from the issue of the £200,000 convertible loan note, all of the existing A, B and C shares would be reclassified.

(4) The existing equity held by investors (other than TCL and IW) and management equity would be converted into new A ordinary shares representing 24.9% of the total equity.

(5) Dickson Minto and Quest would amend their supplier options, provided their fees are brought up to date. The hurdles for their warrants would be rebased as agreed with TCL/IW.

Summary report of the rescue funding proposal March 2007

38. A report with the title: 'Summary Report of Principal Legal Terms relating to Rescue Funding Proposal' and dated 9 March 2007 was prepared by Dickson Minto. It was proposed that the existing Consortium investors would make further investments of £700,000 in stages according to 'a series of equity milestones'.

39. The non-Consortium shareholders were given the opportunity to subscribe on a pro-rata basis between them for additional equity if they so wished by the first 'equity milestone' in May 2007, (though they were not obliged to provide any further equity funding). According to Mr McDonald, most of the investors of the 2006 funding round also invested in the 2007 rescue funding exercise. But the Consortium investors as a group emerged to become the major shareholders owing 55% of the equity.

40. The Summary Report also set down conditions specific to the shareholder directors, including: (a) the managing director would leave; (b) all four directors would surrender their existing A Shares to be converted to shares with no voting rights; (c) their equity would be diluted; (d) their remuneration packages reduced.

41. According to Mr McDonald, a precondition of the Consortium Investment was that Mr Noble would be appointed as Chairman of the Company to drive and oversee the performance and report regularly to the investors. This precondition was evidenced by item (vii) of the 'Principal Terms of Consortium Investment' in the Summary Report:

> 'Marcus Noble is to be appointed to the board as Executive Chairman (we understand that, also as a condition of the Investment, Scott Carnegie was recently appointed to the board as Finance Director). Each of Mr Noble and Mr Carnegie will enter into appointment agreements with the Company, which will require, among other things, for theme each to commit to devoting not less than 1-2 days per week of their time for the Company for the 12 months immediately following the entry into the Subscription Agreement. Each of them are to be paid £4,167 per month for their services.'

The 'Notional Ratchet Operation' required with the injection of new equity

42. The Summary Report of 9 March 2007 contains schedules of the equity holding of the groups of investors and their relative percentage holdings before and after the rescue funding exercise. The Notes to the table setting out the 'Equity Position' of the investors after the rescue funding include the following:

(1) '… the ratchet mechanism has been notionally operated to dilute the A Shares immediately before certain A Shares are cancelled, to the benefit of all former holders of B and C Shares …'

(2) 'The above table does not take account of the existence of the outstanding options held by each of 22 Nominees Limited, Quest Advantage Limited ….'

43. Section 5 of the Summary Report under the heading of 'Treatment of Existing Options' stated, *inter alia*, the following:

> 'The Company has outstanding options granted to each of 22 Nominees Limited and Quest Advantage Limited under 2 separate option agreements, each in respect of up to 2.5% of the issued equity

> share capital of the Company on the occurrence of an "Exit" …. It is proposed that these option agreements are to be amended with the effect that each of these option holders' entitlements will be diluted in line with the dilution of those option holders' equity holdings in the Company following completion by the Consortium of the Investment. Such amended options will therefore be in respect of up to 1.5% of the issued equity share capital of the Company on an "Exit". The diluted options will be in respect of F Shares.'

44. According to Mr McDonald, the supplier options which had been granted to Dickson Minto and Mr Noble through their nominees were required to be amended as 'a pre-condition of the 2007 refinancing exercise'; that those who invested in the rescue funding exercise in 2007 'considered it unfair that the holders of the supplier options would be getting a "free ride",' if the options were not diluted along with the rest of the shareholders.

45. Mr McDonald's evidence further explained that:

> '… the supplier options put in place in 2006 were dilution proof as they referred to a percentage of equity not a fixed number of shares. …it was agreed that the options granted in 2006 were to be varied so that the amount of equity available was to be reduced by around one half, and the optionholders conceded to this as otherwise the refinancing would not have proceeded and their options would then have become worthless.'

The letter of appointment to a directorship

46. The document (A3) produced at the start of hearing is a letter from Vermilion to appoint Mr Noble as 'Executive Chairman of the Company' from the date of the letter, being 16 March 2007.

47. The appointment was 'subject to the Memorandum and Articles of Association of the Company', and the letter set out the terms of the appointment in the equivalent space of two pages, followed by the signing details of the parties.

48. Excerpts of the terms of the appointment relevant to this appeal are as follows:

> '4. During the period of your appointment you shall devote at least 1-2 working days per week, with a minimum of 6 days per month, of your time in the fulfilment of your duties as a Director.
>
> 5. In consideration for your services as a Director of the Company in terms of this Agreement you will be entitled to receive a fee of £4,167 per month (Plus VAT if applicable) such fees to be payable quarterly in arrears.
>
> 6. The Company shall, within 30 days of submission of receipts, reimburse all reasonable travelling, accommodation, meal and other expenses wholly, exclusively and necessarily incurred by you in the performance of your duties as a Director.
>
> […]
>
> 12. It is agreed that you are not an employee of the Company or of any other member of the Group and that this Agreement shall not constitute a contract of employment but a contract for services. It is anticipated

> that any fees received by you under this Agreement are subject to taxation under Schedule D.
>
> 13. to 17. […]'

The Option Agreement of 2007

49. Instead of variation agreements to dilute the supplier options, new option agreements were drawn up in 2007 in the end. Mr McDonald's explanation was:

> '… variation agreements were not entered into at the time … as there was considerable time and financial pressure to complete the 2007 refinancing (as wages etc required to be funded) and having two documents rather than four was seen as simpler. There were already a very considerable number of documents given the significant amendments… The transaction bible for the 2007 refinance is bulky and again there was considerable pressure on fees…. The consideration for the 2007 option was effectively the cancellation of the prior options which had been granted in 2006.'

50. The option agreement between Vermilion and Quest was dated 2 July 2007, and specified to be 'over F Ordinary Shares representing up to 1.5% of equity', whereas:

> 'The Company has, at the date hereof, an authorised share capital of £118,973.13 divided into £1,380,554 D ordinary shares of £0.01 each ("D Shares"), 5,522,216 E ordinary shares of £0.01 each ("E Shares") and 4,994,543 F ordinary shares of £0.01 each ("F Shares").

51. Clause 2 of the agreement on 'Subscription Option' states as follows:

> '2.1 The Company hereby grants to the Optionholder an option (the "Option") to subscribe for, subject to Clause 6, such number of Ordinary Shares as represent the Relevant Percentage (up to a maximum of 1.5 per cent) as herein defined of the issued equity share capital (as defined in section 744 of the Act) of the Company as enlarged by the Supplier Option but before any enlargement as a result of the Permitted Issues/Options or any variation of share capital permitted in accordance with this Agreement (the "Option Shares").
>
> 2.2 No consideration shall be payable for the grant of the Option.
>
> 2.3 The existing option granted to the Optionholder by the Company and dated 1st February 2006 shall lapse with effect from the time that both parties have executed this Agreement.'

52. Under the heading of 'General' for Clause 11 of the agreement, it is stated:

> 'This Agreement contains the entire agreement between the parties or any of them with respect to the matters contemplated herein and shall superseded all prior offers, proposals, representations, agreements and negotiations relating thereto …'

The Novation Agreement of 2007

53. The novation agreement was signed by Mr Carnegie on behalf of Quest on 9 June 2016. The novation agreement was supplemental to the option agreement dated 2 July 2007 between Quest and Vermilion. In effect, the novation agreement released Quest as the 'Existing Optionholder' of the 2007 Option, in favour of Mr Noble as the 'New Optionholder' of the 2007 Option. The timing of the novation agreement was

in anticipation of the exercising of the Option following the sale of Vermilion to FactSet, which was to be completed in November 2016.

Non-statutory clearance request

54. On 18 November 2016, French Duncan acting for Mr Noble and Vermilion, submitted to HMRC a non-statutory clearance request ('NSC'). In that request, the agent asked for HMRC's agreement that the gain, in the sum of £636,238 on the exercise of the 2007 Option by Mr Noble, was liable to Capital Gains Tax ('CGT').

55. On 24 November 2016, Officer Matthews telephoned the agent regarding the NSC request. The agent's note of call recorded Officer Matthews as having said: 'under a more purposive approach it would not seem appropriate' to treat the 2007 Option as an ERS option. However, 'given the letter of the law, he was not able to authorise the treatment'.

56. On 14 December 2016, HMRC gave the following decisions:

(1) the option granted on 2 February 2006 is not an employment-related securities option under s 471 ITEPA;

(2) the option granted on 2 July 2007 is an ERS option since the grant of the option is not an excepted option covered under s 471(3) ITEPA. Consequently, the exercise of the option is a chargeable event within s 477 ITEPA, and the taxable amount of the gain on acquiring the securities counts as employment income of Mr Noble in the relevant year.

57. On 4 January 2016, the agent spoke to Officer Clarke over the phone, who was recorded (by the agent) as having said: that 'it was probably not the intention of the legislation that such situations should be caught'; that 'the legislation was not anti-avoidance' [to lend itself to a purposive test]; that 'it deemed shares to be by reason of employment to avoid argument over the purpose behind the acquisition of shares'.

Compliance check and review conclusion

58. On 28 February 2017, an Employer Compliance enquiry was opened into Vermilion under reg 97 of Income Tax (PAYE) Regulations 2003. The check was undertaken as a result of the non-statutory clearance request.

59. On 27 July 2017, the agent wrote to accept HMRC's offer for an internal review, and enclosed a copy of the notes of the telephone discussions with Officers Matthews and Clarke. The agent stated the officers' respective comments as: (a) 'on a purposive view the ERS provisions do not seem appropriate'; and (b) that 'it was probably not the intention that such situations should be caught'.

60. On 27 September 2017, HMRC issued the review conclusion:

(1) Regarding the notes of telephone discussions, the officers were not given the opportunity to agree these notes.

(2) Even if the officers did suggest that it was not the intention of the legislation, it remains a factual test, and the facts support the conclusion that the 2007 Option was employment related.

(3) That HMRC's discretionary powers are limited, and cannot rewrite the legislation to meet the demands of present case, as stated by Lord Hoffmann in *R v IRC ex parte Wilkinson* at [21]:

> 'This discretion enables the commissioners to formulate policy in the interstices of tax legislation, dealing pragmatically with minor or transitory anomalies, cases of hardship at the margins or cases in which as statutory rule is difficult to formulate … It does not justify construing their powers so widely as to enable the commissioners to concede, by extra-statutory concession, an allowance which Parliament could have granted but did not grant …'

The appellant's case

61. Mr Simpson submitted that the legal issue is whether the 2007 Option over 1.5% of the Company was '*made available by [Mr Noble's] employer*' within the meaning of s 471 ITEPA. His submissions, as I understand them, focused on making the case that the 2007 Option was not 'made available' by Vermilion, as a matter of fact, and as a matter of law.

As a matter of fact

62. Firstly, the 2007 Option was made available to Mr Noble only because he already had the 2006 Option, and that he was willing to give up 40% of his 2006 Option. Even if it is necessary to identify a person other than Mr Noble by whom the 2007 Option was 'made available', in the present case, that person is the other shareholders in the appellant who agreed that Mr Noble could continue to have option over 1.5% of the appellant. In other words, on no view can it be said that the appellant 'made [the 2007 Option] available' to him.

63. Secondly, the legal issue arises in the present case only because of the eventual form adopted to reduce the percentage of the Company over which Mr Noble had an Option. It is plain that the reduction could have been achieved in a number of different ways, including, for example, simply amending the 2006 Option Agreement by replacing '2.5%' with the figure '1.5%' where it appeared, as illustrated:

(1) In the frontispiece, the definition of 'Relevant Percentage', clause 2.1, and the appendix where it appears opposite Quest's name (it would not have been necessary to change it in the definition of 'Supplier Option' or otherwise in the appendix).

(2) Various other differences between the 2006 Option Agreement and the 2007 Option Agreement, all of which in context appear to be immaterial to the present issue, could also have been effected by amendment.

(3) For reasons not relating to tax, the mechanism chosen was instead the cancellation of all the 2006 Options and the grant of the 2007 Options in their place: clause 2.3 of the 2007 Option Agreement.

(4) Had the mechanism of amending the 2006 Option Agreement been used, for example, or indeed had there been a separate instrument by which Mr Noble surrendered the 2006 Option so far as relating to 1% of the shares in the

Appellant, it is clear that the 2006 Option, so far as it were not cancelled, would have remained outside the scope of s 471 ITEPA.

As a matter of law

64. As to the legal argument why the 2007 Option was not 'made available' by Mr Noble's employer, Mr Simpson urged on the Tribunal to adopt a purposive approach in interpreting the charging provision of ss 477- 483 of ITEPA:

(1) The provisions relevant to this appeal is to be interpreted having regard to their purpose and in the light of a realistic appraisal of the facts of the case with reference to that purpose: *UBS* at [61] and [68].

(2) What the material facts are is to be determined having regard to the purpose of the provision: *BMBF* at [32].

(3) 'The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically': Ribeiro PJ in *Arrowtown* at [35].

(4) This approach applies in cases not involving tax avoidance to find in favour of the taxpayer: *Pollen Estate* at [24], [48] and [49], where charities relief from stamp duty land tax was construed more broadly than the literal interpretation of the legislation would allow.

65. For statutory construction of the provisions under Part 7[1] of ITEPA, Mr Simpson submitted that:

(1) The interpretation required of s 471 ITEPA is a definitional one, concerning the scope for the charge to tax. It is therefore necessary to identify the purpose of those provisions generally.

(2) At its broadest, the purpose of Part 7 ITEPA is to charge gains made on shares an employee is given by his employer to income tax rather than capital gains tax. The reason is that the shares are part of the reward for the employment, and so the whole benefit from them should be charged as employment income.

(3) The purpose of Part 7 ITEPA is clear from the statements made by the Paymaster-General (Ms Primarolo) at the committee stage of the Finance Bill 2003 in relation to the predecessor provision of Part 6 ITEPA:

> 'A point to emphasise here is that the rules introduced by schedule 22 seek to tax value obtained by reason of employment.'[2]

(4) In the present case, the 2006 Option was not obtained 'by reason of employment', and this likewise applies to any value obtained from the 2006 Option, which would include the 2007 Option.

(5) In addition, Part 7 of ITEPA has the purpose of preventing tax avoidance, as noted by the Paymaster-General:

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[1] Mr Simpson's skeleton argument refers throughout to the provisions as under Part 6 (on 'Income which is not earnings or share-related'). It is probably a typographical error and I have substituted Part 7 on 'Income and Exemptions relating to securities' in the body of the decision.

[2] Standing Committee B, 22 May 2003, col. 256.

> 'Let us be quite clear about what the Government are trying to do here. The new rules target only non-commercial, artificial value manipulation, which often involves substantial cash bonuses.'[3]

(6) Furthermore, there was a recognition of a need to ensure that where the predecessor provisions went beyond their proper task, so that people paid more tax than Parliament intended, this should be remedied:

> 'Schedule 22 provides a coherent, consistent and fair way forward for all of those involved in share schemes. There is tax on value when it is unlocked and accessible by reason of employment. There are major avoidance schemes that need to be blocked and we are happy to give details of them, but hon. Members can see those advertised on the internet. The rules must ensure that there is fairness throughout the system. Some people may have been paying too much tax.'[4]

(7) The ERS legislation under Part 7 of ITEPA contains changes to block avoidance schemes, especially those changes contained in the Finance Act 2005. In a statement on 2 December 2004 on the Finance Bill 2005 concerning the proposed amendments to the ERS provisions, the Paymaster-General described the 'objective' of the amendments as being that 'of subjecting the rewards of employment to the proper amount of tax and NICs, however the rewards are delivered'; and the 'intention' of the legislation as being that, 'employers and employees should pay the proper amount of tax and NICs on the rewards of employment'.

66. Applying a purposive interpretation of the ERS provisions to the facts of the case viewed realistically, *the 2007 Option was not 'made available' by the appellant*:

(1) The substance of the transaction by which the 2007 Option was granted to Mr Noble was not to confer on him value earned by his employment, or to give him an opportunity to get the benefit of such value, but to deprive him of value to which he was otherwise already entitled, or had the opportunity to get the benefit of.

(2) In economic terms, some of Mr Noble's share in the value of the appellant was passed to other investors in exchange for their financial support for the business. The same occurred in relation to Dickson Minto, whose Option was also reduced.

(3) The right of the 2007 Option was not 'made available' by Mr Noble's employer. Instead it was 'made available' by Mr Noble's surrender of his existing 2006 Option.

(4) If Mr Noble had not had the 2006 option to surrender, then the 2007 Option would not have been granted to him, notwithstanding the fact that he was chief executive of the appellant at the time. The 2006 Option was granted for services Mr Noble provided as an external adviser in relation to the 2006 funding round.

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[3] Standing Committee B, 22 May 2003, col. 264.

[4] Standing Committee B, 22 May 2003, col. 252.

(5) The 2007 Option was not intended as a reward for any employment of Mr Noble with the appellant. It was part of the award for services provided in early 2006, under what was manifestly not an employment relationship.

(6) Mr Simpson submitted that s 483 ITEPA makes 'specific provision' for options replacing employment-related securities options to be treated in the same way as the original options, and argued that the corollary should be:

> 'If options that are not employment-related securities option are replaced by ones that, on their own, would be, the latter should be outside the regime.'

(7) As to HMRC's approach, Mr Simpson submitted that:

(a) HMRC apply a particularly literal interpretation of s 471 ITEPA.

(b) In any event, the 2007 Option could not be said to have been 'made available' by the appellant (as the employer) as opposed to other shareholders in the appellant.

(c) HMRC's position ignores the 2006 Option and the substance of the transactions that reduced the percentage of the appellant over which the 2007 Option was granted.

(d) HMRC's position depends on the existence of a *scintilla temporis* in between the cancellation of the 2006 Option and the grant of the 2007 Option and does not have a 'powerful grasp on reality': *Ingram* at 303.

67. In the alternative, the legal submission from Mr Simpson is that *the 2007 Option was in substance the same as the 2006 Option*:

(1) The 2007 Option was only 'made available' to Mr Noble because he already owned the 2006 Option it replaced; and for the purposes of s 471 ITEPA, the same option as the 2006 Option, notwithstanding the formal mechanism by which the 2006 Option was reduced.

(2) *Roome v Edwards* concerned a capital gains tax avoidance scheme that depended on whether a fund created using assets of a trust was a separate settlement from, or part of the same settlement as, the initial trust. The House of Lords (at 292 and 297) held that the two arrangements formed a single settlement for capital gains tax purposes.

(3) Thus, whether two funds are for tax purposes to be treated as a single fund depends on all the circumstances of the case, including the identity and intention of the parties, the form and the terms of the transactions: see also *Swires v Renton* at 500.

(4) Applying this case law to the 'options', which is a legal term that is also used by business people and laymen, 'the question whether a particular set of facts amount to [an option] should be approached by asking what a person, with knowledge of the legal context of the word under established doctrine and applying this knowledge in a practical and common-sense manner to the facts under examination, would conclude'.

(5) The existence of separate documents is not decisive. The intention of the parties in entering the 2007 Option Agreement was not 'to wipe the slate clean' and start gain, but was instead to cancel some of the 2006 Option, while leaving the rest in existence on substantially the same terms.

HMRC's case

On statutory construction

68. In response to the appellant's submissions as regards the approach to statutory construction, HMRC reminded the Tribunal that the cardinal rule is to construe legislation according to the intention expressed in the language. The function of the court is to interpret legislation, according to the express language of the statute.

69. When construing an Act of Parliament, the court will draw upon the presumptions and principles of construction that have evolved over time and as necessary. The use of extraneous material is but one element of the construction process. While the courts are increasingly prepared to look at any material that is likely to be genuinely helpful in illuminating the context within which the legislation is to be construed, two cautionary notes must be sounded.

70. Firstly, background material must not be allowed to take precedence over the clear meaning of the words used. The cardinal rule that legislation should be construed according to the intention expressed in the language used must not be lost sight of, as reiterated in *Milton v DPP* at [24]:

> 'If the court is uncertain as to the meaning, it may well be helpful to consider background material in order to discover the "mischief" at which the change in the law was aimed. However, this case illustrates the dangers of so doing. It is clear to me that the district was led into error by his reference to the White Paper.'

71. Secondly, a certain degree of care needs to be employed in ascertaining what material is helpful when construing an Act of Parliament.

(1) In contractual cases, the factual matrix refers to material facts reasonably available to the parties to the contract. That would be an inapposite criterion for identifying material helpful in construing an Act of Parliament, which binds all. Clearly, the only material that ought to be used when construing an Act is that material reasonably available to the public in general.

(2) In *BT v Office of Communications* the Competition Appeal Tribunal cited *Black-Clawson Ltd* at 646:

> 'Public law instruments like statutes … are – like contracts – to be construed in the context of the factual matrix in which they are set.'

(3) What comprises the relevant matrix of fact in any given case depends on the nature of the instrument being construed: the law 'permits reference to all the background knowledge which would reasonably be available to the audience to whom the instrument is addressed' (*AG of Belize* at [16]).

(4) However, in the case of a public law instrument, which is promulgated to the world at large, the relevant factual matrix will only extend to the material reasonably available to the public at large, and so will be typically narrower than the relevant factual matrix in a contractual context.

(5) After *Pepper v Hart*, it is clear that the circumstances in which Parliamentary material may be deployed as an aid to construction are rather narrower than those pertaining to other forms of extraneous material. The courts

have been astute in resisting reference to Parliamentary material where the criteria set out by Lord Browne-Wilkinson in *Pepper v Hart* at 640 are not met.

On agent's reference to comments made by HMRC officers

72. In the letter of 27 July 2017, the agent appears to be suggesting that the legislation is not designed to apply to his client's circumstances, and appears to be attempting to rely on the comments made by HMRC officers Clarke and Matthews.

73. HMRC say that opinions expressed by an officer of HMRC in an attempt to be sympathetic to a taxpayer's situation does not supplant the legislation.

The deeming provision

74. In oral submission, Mr Waters emphasised the deeming provision of s 471 ITEPA in relation to the meaning of 'by reason of employment' as given in Manual ERSM20210 on 'Employment-related securities and options:

> 'The deeming provision set out in … subsection (3) of ITEPA03 /S471 state[s] that if it is the employer or someone connected with the employer who makes available the right or opportunity, then the employee is deemed to have acquired the securities or interest or option by reason of his/her employment.'

75. Mr Walters submitted that whether the 2007 Option was granted 'by reason of employment' is a factual test. The material fact is that Mr Noble was given the right to acquire shares under the Option on 2 July 2007 *when* he was a Director of the appellant company, and that was sufficient for the deeming provision to apply that the grant of the 2007 Option was 'by reason of' employment.

Discussion

76. The single issue for determination is whether the 2007 Option granted on 2 July 2007 when Mr Noble was already appointed as a director of Vermilion was an employment-related securities option within the meaning of s 471 ITEPA.

77. There is no dispute that the Regulation 80 determination and Section 8 notice were validly issued, following the decision given by HMRC to the non-statutory clearance request. The onus of proof is on the appellant (as provided under s 50(6) TMA) that it has been overcharged.

78. Whilst there is only one issue for determination, there are several arguments being advanced by the parties for their respective positions. The parties' arguments are presented as reasonably fully as the scope of this Decision allows. I intend to deal with only those arguments that are material to the determination of this appeal.

79. Both parties have given much coverage on the scope and relevance as regards the use of Parliamentary material as an aid to statutory construction. For this reason, the matter of statutory construction is addressed as a preliminary issue before considering the substantive matter.

The preliminary issue on statutory construction

80. The task for all courts and tribunals 'is to construe the statutory language of a particular provision in its context and having regard to the scheme of the legislation as a whole in order to ascertain and give effect to its purpose' (*English Holdings* at [63]). The submissions by the parties in relation to statutory construction touch upon some fundamental issues how this task is to be undertaken.

The use of Parliamentary material in statutory construction

81. In *Pepper v Hart*, the Lordships deliberated on the legitimate extent of the use of Parliamentary material as an extrinsic aid in statutory construction. The leading judgment of Lord Browne-Wilkinson at 634 is often referred to as supporting the admissibility of Hansard to aid statutory construction in certain limited circumstances:

> '… as a matter of law, there are sound reasons for making a limited modification to the exiting rule (subject to strict safeguards) unless there are constitutional or practical reasons which outweigh them. In my judgment, subject to the questions of the privilege of the House of Commons, reference to Parliamentary material should be permitted as an aid to the construction of legislation which is ambiguous or obscure or the literal meaning of which leads to absurdity. Even in such cases references in court to Parliamentary material should only be permitted where such material clearly discloses the mischief aimed at or the legislative intention lying behind the ambiguous or obscure words…'

82. Counsel for the appellant has similarly relied on *Pepper v Hart* as the authority for importing ministerial statements as an aid to statutory construction, while the respondents caution against such use of Parliamentary material. As for the Tribunal, Mr Simpson's references to Hansard have been permitted *de bene esse*, since to refuse to consider the material on any of the grounds as adumbrated by Lord Browne-Wilkinson would have been to prejudge the case before hearing the argument.

83. Whilst accepting that the statements of the Standing Committee at the Bill stage in relation to the ERS provisions to be enacted in ITEPA represent legitimate Parliamentary material, the exclusionary rule remains the default position, and the threshold condition has to be met before allowing the recourse to such material as an aide to statutory construction. The threshold condition, embedded in Lord Browne-Wilkinson's pronouncement at 634, is formulated more succinctly at 640 as follows:

> '… subject to any question of Parliamentary privilege, that the exclusionary rule should be relaxed so as to permit reference to Parliamentary material where (a) legislation is ambiguous or obscure, or leads to an absurdity; (b) the material relied upon consists of one or more statements by Minister or other promoter of the Bill together if necessary with such other Parliamentary material as is necessary to understands such statements and their effect; (c) the statements relied upon are clear.'

84. To take the *de bene esse* approach does not mean that the courts cannot refuse the admissibility of Parliamentary material where the conditions for admissibility have not been strictly complied with: *Spath Holme* at 391-392, 398-399, 407-408, and 413, and *R v A* at 79. Lord Hoffmann's observation at [40] in *Robinson* is instructive:

> 'I am not sure that it is sufficiently understood that it will (sic) very rare indeed for an Act of Parliament to be construed by the courts as meaning something different from what it would be understood to mean by a member of the public who was aware of all the material forming the background to its enactment but who was not privy to what had been said by individual members (including Minsters) during the debate in one or other House of Parliament. And if such a situation should arise, the House may have to consider the conceptual and constitutional difficulties which are discussed by my noble and learned friend Lord Steyn in his Hart Lecture ((2001) 21 Oxford Journal of Legal Studies 59)[5] and were not in my view fully answered in *Pepper v Hart*.'

85. Has the threshold condition been met in the present case? There is no suggestion or submission from Mr Simpson that the provision under s 471 ITEPA is 'ambiguous or obscure'. In fact, the appellant seems to have recognised, even if not conceded, that the 2007 Option is caught by the clear meaning of a literal interpretation of s 471 ITEPA. Neither is there any express submission that s 471 provision leads to an absurdity for me to consider if the threshold condition set out in *Pepper v Hart* has been met. The appellant may not like the result of HMRC's literal interpretation of s 471, but no case has been made that such an interpretation has led to an 'absurdity'.

86. The exclusionary rule is the default position, and any departure from the exclusionary rule needs to be justified by a necessity to resolve issues in interpretation occasioned by the relevant provision being ambiguous or obscure, or leading to an absurdity. The dictum in *Pepper v Hart* refers to 'a limited modification to the exiting rule (subject to strict safeguards)'. The appellant's case for importing Parliamentary material fails at the first hurdle. It is unnecessary to examine the substance of the material by applying the stringent tests as formulated by Lord Browne-Wilkinson to establish the relevance and clarity of the statements relied upon.

Whether a distinction between a literal and a purposive construction

87. Admittedly, the focus of Mr Simpson's argument on the use of Parliamentary material as an extrinsic aid is not so much to resolve any ambiguity in the meaning of the provision, but to discern the 'mischief' of the provision in order to support a purposive interpretation.

88. It is the appellant's case that HMRC have brought the 2007 Option under the charging provision of s 471 ITEPA by adopting a literal interpretation. It is argued that if a purposive interpretation is applied to s 471 provision, the 2007 Option did not fall within the *purpose* of the charging provision, which is to target the grant of a share option that is in effect a reward of employment.

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[5] The extra-judicial statement by Lord Steyn, given as the Hart Lecture at the University College Oxford on 16 May 2000, was a closely reasoned critique of *Pepper v* Hart. On one interpretation, Lord Steyn's lecture is aimed to illustrate what was referred to in *Pepper v Hart* as 'the constitutional or practical reasons which outweigh' Lord Browne-Wilkinson's 'sound reasons for making a limited modification to the existing rule' (at 634). See too 'A Retreat from *Pepper v Hart*? A Reply to Lord Steyn' by Professor Stefan Vogenauer, (2005)25 *Oxford Journal of Legal Studies*, 629.

89. It seems to me the emphasis on purposive construction as distinct from a literal interpretation suggests a dichotomy which is false rather than real, as observed by the Upper Tribunal in *HMRC v Trigg* at [16]:

> 'The application of purposive construction does not mean that the literal meaning of the statutory language is to be ignored. It will often be – indeed it must be so in the vast majority of cases – that the purpose of a statutory provision which is discerned from the words of the statute will be the same as the literal meaning of those words. The will of Parliament finds its expression in the statutory language. […]'

90. Where the statutory meaning of a provision does not suffer from being ambiguous, obscure, the 'mischief' which the provision seeks to cure is to be found within the statutory wording. The Administrative Court in *Milton v DPP* has cautioned against importing extrinsic aid at [24], even if it is Parliamentary material:

> '… this case well illustrates the danger of referring to background material such as a White Paper [6] as an aid to construction in circumstances in which that ought not to be done. When construing a statute, the court should first examine the words themselves. If the meaning in clear, there is no need to delve into the policy background.'

91. There is no good reason for interpreting the purpose of s 471 ITEPA outside the wording of the provision itself, especially where there is no ambiguity; *Astall v HMRC* at [44]:

> '… the court should assume that the provision had some purpose and Parliament did not legislate without a purpose. But the purpose must be discernible from the statute: the court must not infer one without a proper foundation for doing so.'

92. The courts must guard against inadvertently importing a different meaning due to the use of extrinsic material in statutory construction, *HMRC v Trigg* at [34]:

> 'Whatever underlying purpose may be identified, it is not the task of the courts to import a different meaning to the provision in question than can be properly be attributed to it, just merely because of a perception that such a meaning would better suit the purpose so identified. That … would be an exercise in rectification and not construction.'

93. For these reasons, I do not consider it necessary or beneficial to import the proposed ministerial statements for the construction of s 471 ITEPA. Such an approach invariably requires a degree of interpretation of the extrinsic material itself; thereby superimposes a meta-layer of construction to construe the statute proper.

94. In any event, it seems to me that the purpose of the provisions under Part 7 of ITEPA is not in doubt: it is to bring into the income tax regime the award of securities or securities options which is employment-related. More specifically, from HMRC's internal manual ERSM20210 (included in the bundle) on '*Employment-related securities and options: "by reason of employment"*', it is observed that:

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[6] In *Spath Holme*, Lord Nicholls observed at 397-398 that there is no rational basis for distinguishing between different types of aids to construction such as international treaties, white papers, a preamble to a statute and explanatory notes.

> 'Prior to Finance Act 2003, the test as to whether the legislation could charge gains to Income Tax, as opposed to CGT, was usually whether the shares or other securities were acquired "by reason of employment". The factual test made it very easy for directors to claim that their shares were "founders' shares" and not acquired by reason of their employment and in that way to take employment award associated with those shares out of the charge to Income Tax and NICs. To prevent this, Finance Act 2003 introduced a deeming provision based on the one that existed for the notional loans and stop-loss legislation in the old ICTA88/s162 (Chapters 8 and Part 3 ITEPA 2003).'

95. It would seem the deeming provision is a specific anti-avoidance provision, targeted against the 'founders' shares', which may have a greater scope than strictly required, and can lead to unforeseen and unwelcome consequences: *Steele v EVC*.

96. In my judgment, the critical issue in this appeal lies with the interpretation of the *deeming* provision it contains. The strength of HMRC's case is simple but potent, and rests on the deeming effect of the provision under subsection 471(3) ITEPA. The deeming effect of a statutory provision presumes a state of affairs, and in some instances, such a presumption may even be a statutory fiction, but nonetheless is capable of precluding any further findings of fact to the contrary. (The deemed forfeiture provision under paragraph 5 of Schedule 3 to Customs and Excise Management Act 1979 is a case in point: see *HMRC v Jones*.)

97. The respondents' reliance on the deeming provision is clearly stated in their statement of case, and emphatically put forward in oral submissions. However, neither parties have referred to case law specific to the interpretation of a deeming provision. I have considered whether the parties should have been invited to make written submissions before the release of the decision. In view of the delay this would have caused to the conclusion of these proceedings, and on the basis that my interpretation of s 471(3) is addressing directly the arguments ventilated by the respondents in the hearing, and that the parties have a right of appeal against this decision, I have set out my reasoning in relation to the statutory construction of a deeming provision, without having first heard parties' submissions in this respect.

The application of the deeming provision under s 471(3)

98. It is common ground that the statutory exceptions under s 471(3)(a) and (b) do not apply to Mr Noble's circumstances, so the wording of the deeming provision under s 471(3) that concerns this appeal relates only to the following:

> 'A right or opportunity to acquire a securities option made available by a person's employer, …is to be regarded for the purposes of subsection (1) as available by reason of an employment of that person …'

The meaning of 'by reason of employment'

99. The terms of agreement for Mr Noble's appointment to the directorship in Vermilion were set out as a 'contract for services', and not 'a contract of employment'; clause 12 of the letter of appointment stated that it was agreed that Mr Noble would not be 'an employee of the Company' (§48). In like manner, the appointment of Mr Carnegie as the Financial Director was under a contract for

services, and not a contract of employment. No issue was taken of Mr Noble's contract was for his services, but nothing turns on the fact that Mr Noble was not an employee in relation to the service agreement that he had entered into with Vermilion.

100. The parties are agreed that as a director of Vermilion, Mr Noble was an employee for the purposes of ITEPA; by virtue of s 5(1) ITEPA: 'The provisions of the employment income Parts that are expressed to apply to employments apply equally to offices', and sub-s 5(2)(b): an 'office-holder' is defined as an 'employee'.

101. The phrase 'by reason of' in the employment context was given significant judicial attention in *Wicks v Firth*, which concerned whether scholarships, awarded by the employer ICI to children of its employees, constituted 'fringe benefits' to be taxed as employment income of the fathers under s 61 of the Finance Act 1976 ('FA 1976'). The Court of Appeal by a majority found in favour of the Crown. Lord Denning MR (dissenting) allowed the taxpayer's appeal, having found that: (a) the scholarships awarded fell to be taxed under s 61 FA 1976, and (b) the scholarships qualified for exemption under s 375 of ICTA 1970. On appeal by the taxpayer to the House of Lords, both aspects of Lord Denning's decision were upheld by a majority.

102. The judicial explication of the phrase 'by reason of' employment is to be found in the Court of Appeal decision in *Wicks v Firth*, per Lord Denning, at 363:

> 'It seems to me that the words "by reason of" are far wider than "therefrom" [in the predecessor provision]. They are deliberately designed to close the gap in taxability which was left by the House of Lords in *Hochstrasser v Mayes* [1960] A.C. 376. The words cover cases where the fact of employment is the *causa sine qua non* of the fringe benefits, that is, where the employee would not have received fringe benefits unless he had been an employee. The fact of employment must be one of the causes of the benefit being provided, but it need not be the sole cause, or even the dominant cause. It is sufficient if the employment was an operative cause – in the sense that it was a condition of the benefit being granted. …'

103. Lord Denning found the father's employment with ICI to be the necessary, though not sufficient, condition for eligibility for an award; other conditions being the student's attainments and obtaining a place at a university. The father's employment was the *causa sine qua non*, the condition without which nothing:

> 'If two students at a university were talking to one another – both of equal attainments in equal need – and the one asked the other "Why do you get this scholarship and not me?" He would say "Because my father is employed by ICI". That is enough. The scholarship was provided for the for the son "by reason of" the father's employment.'

104. Turning to the facts of the present case, if Mr Carnegie were to ask Mr Noble: 'Why do you get the 2007 Option and not me?' Mr Noble would say 'Because I got this 2006 Option which has to be diluted to become the 2007 Option.'

105. As a matter of fact, I find Mr Noble's directorship was not the *causa* for the grant of the 2007 Option, but for the same reason as Dickson Minto being granted a 2007 Option. Without their respective Supplier Options granted in 2006, neither Mr Noble nor Dickson Minto would have been granted (via their nominees companies)

the right to the 2007 Options. The right to acquire the 2007 Option in each case emanated from the right under the Supplier Option received in 2006.

106. The respondents would not dispute that these are the facts in relation to the 2007 Option either. However, their contention is that the deeming effect of s 471(3) means that the grant of the 2007 Option '*is to be regarded*' as having been made available by reason of Mr Noble's directorship, despite any fact-findings to the contrary.

The deeming effect of being 'made available' by employer

107. In *Wicks v Firth* Lord Denning stated (at 364) the effect of the deeming provision in relation to his conclusion on the substantive issue:

> 'Even if I were wrong in thinking that these scholarships were awarded "by reason of his employment" of the father, nevertheless, the statute contains a "deeming" provision. Section 72(3) says that when a fringe benefit is "provided by his employer", it is deemed to be "by reason of his employment".'

108. In *Hochstrasser*, the issue was whether the payments made by an employer to employees in respect of losses sustained by them on the sales of their houses on relocation were taxable as emoluments under the description of 'salaries, fees, wages, perquisites or profits whatsoever therefrom', with 'therefrom' being taken as to mean 'arising or accruing from' any office or employment. The House of Lords held that the payments were not emoluments, and that the issue turned on whether the employment was the *causa causans* or only the *causa sine qua non* of the benefit, and that the Crown had the burden to demonstrate that the payment was a reward for the employee's services.

109. In *Wicks v Firth* Oliver LJ remarked at 370 that in relation to the benefits code introduced after *Hochstrasser*, the philosophical distinction observed between *causa causans* and *causa sine qua non* in *Hochstrasser* was no longer helpful; that a benefit 'derived' from the employment did not have to be invested with the employer's intention to remunerate the employee for the performance of his duties. He continued by saying:

> 'One is directed to see whether the benefit is provided by reason of the employment and … that … involves no more than asking the question "what is it that enables the person concerned to enjoy the benefit?" without the necessity for too sophisticated an analysis of the operative reasons … the commissioners … rightly found – that the benefit with which the appeal is concerned was provided by the employer so that section 72(3) deems it to be provided by reason of the employment.'

110. The reasoning of Oliver LJ is to link the deeming effect of the said provision to the *provider* of the benefit. In other words, the deeming takes effect so long as the provider is the employer. This dispenses with the need by the courts to enquire into *causa*, or to establish intendment, that a benefit is by reason of employment.

Whether the deeming effect applies in the present case

111. A central part of Mr Simpson's submissions is to argue that the 2007 Option was not 'made available' to Mr Noble by Vermilion, but was 'made available' by Mr

Noble surrendering his 2006 Option, or by the shareholders of Vermilion and not the Company itself, and so on. Mr Simpson's submission in this respect would seem to be an attempt in circumventing the deeming effect by severing the link between the 'provider' of the 2007 Option and Vermilion, of which Mr Noble was a director.

112. In my view, the deeming provision under s 471(3) sets up a presumption, which is to say, upon a finding of fact that 'the person's employer', (or a person connected with that employer), has made available a right or opportunity to acquire a securities option, the deeming effect automatically applies. As Oliver LJ observed, the deeming is to dispense with the deliberation of the nuanced modes of causa, and simply to ask: Was a right to acquire the 2007 Option made available by Vermilion?

113. The contractual parties in the 2007 Option agreement were Vermilion and Quest, the latter acting as the nominee company for Mr Noble. The terms and contents of the agreement are set out earlier, and answer the simple question in the affirmative. The plain fact is that Vermilion, a company with a legal identity, was the grantor of the 2007 Option, as evidenced by the option agreement.

The limitation of the deeming provision

An anomaly arising from the deemed effect

114. On the basis that the deeming provision of s 471(3) applies to the 2007 Option, Mr Waters would say, subsection (3) concludes the issue in this appeal. In most cases, I agree that would most likely to be the end of the matter; in that, if the deeming provision under subsection (3) applies, then it switches on the operative part of the provision under subsection (1).

115. In the present case, I have found that Mr Noble's directorship was not the *causa* for the grant of the 2007 Option. On the other hand, by virtue of subsection (3), the 2007 Option was deemed to be made available by reason of Mr Noble's employment. An anomaly therefore arises, between a statutory fiction as a result of the deeming provision under subsection (3), and my finding of fact that the 2007 Option was not granted by reason of Mr Noble's employment.

116. This anomaly arguably would lead to 'injustice', since Mr Noble's tax liability would be higher by virtue of the deeming provision under s 471(3). I say 'arguably', in full recognition of what Lord Donovan has said in *Mangin v IRC*, that there is 'no equity about a tax'; that there is 'no room for any intendment' in the application of the tax legislation. This kind of anomaly arising from the application of a deeming provision is not uncommon within the tax legislation, the courts' approach in resolving this kind of anomaly is as follows.

The approach in construing a deeming provision

117. In *Harding v HMRC*, the Court of Appeal summarised at [51] the basic principles of interpretation, which applies equally to construing a deeming provision:

> 'There is no real dispute on the basic principles of interpretation. The question is always whether the relevant provision of the statute, upon its true construction, applies to the facts as found, and the statutory should be given a purposive construction in order to determine the

> nature of the transaction to which it was intended to apply and then to decide whether the actual transaction answers to the statutory description: [BMBF] at [32], [36].'

118. Lawrence Collins LJ continued in *Harding* by remarking on the approach to be adopted where the literal interpretation of a particular statute would lead to injustice:

> 'In particular, if a literal construction would lead to injustice or absurdity, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted: e.g. [*Luke v IRC Mangin v IRC*, and *Jenks v Dickinson*]. But there may be cases in which the anomaly cannot be avoided by any legitimate process of interpretation: e.g. [*HMRC v Bank of Ireland*].'

119. In *Marshall v Kerr*, the House of Lords rejected Mrs Kerr's contention that the deeming provision under s 24(7) of the Finance Act 1965 should apply to treat the assets bequeathed to her by her husband (domiciled and resident in Jersey) as having been acquired by the legatee, a Jersey trust company at the date of the testator's death. While the estate was still in administration, Mrs Kerr entered into an instrument of family arrangement within the meaning s 24(11) of FA 1965 to settle her share of the estate under trusts, making the trust company the sole trustee with power to appoint capital to her. By virtue of the deeming provision under s 24(7), Mrs Kerr contended that she was to be deemed as never having owned the assets to become liable for capital gains tax as a settlor. The Special Commissioner's decision in favour of Mrs Kerr was reversed by the High Court, only to be restored by the Court of Appeal, and eventually reversed by the House of Lords.

120. As to 'the correct approach' in construing a deeming provision, at 164 in *Marshall v Kerr* Lord Browne-Wilkinson cited with approval Peter Gibson J's leading judgment of the same case in the Court of Appeal:

> 'For my part I take the correct approach in construing a deeming provision to be to give the words used their ordinary and natural meaning, consistent so far as possible with the policy of the Act and the purposes of the provisions so far as such policy and purposes can be ascertained; but if such construction would lead to injustice or absurdity, the application of the statutory fiction should be limited to the extent needed to avoid such injustice or absurdity, unless such application would clearly be within the purposes of the fiction. I further bear in mind that because one must treat as real that which is only deemed to be so, one must treat as real the consequences and incidents flowing from or accompanying that deemed state of affairs, unless prohibited from doing so.'

121. Whilst Peter Gibson J's approach was endorsed to be correct, his line of reasoning was rejected by the House of Lords as 'fallacious'. In the words of Lord Browne-Wilkinson, it was 'this line of reasoning which led the Court of Appeal to hold that, since the varied beneficiary under the arrangement is deemed to have acquired "the assets" at the date of death, there was never a time at which Mrs Kerr owned such assets and therefore she cannot have been "the settlor" of such assets' (at 168). Lord Browne-Wilkinson continued at 168-169 by giving his analysis why such reasoning is 'fallacious', and the contrary conclusion he reached:

> 'I cannot therefore see any ground for holding that, once assets are vested in the varied beneficiary, the effect of subsection (11) is

> retrospectively to wipe out the process of administration and deem all the assets vested in the varied beneficiary as having been acquired by him at the date of death from the deceased.'

122. At 170, Lord Browne-Wilkinson stated the decision in a nutshell as follows:

> 'In summary, in my judgment the effect of giving the deeming provision in section 24(7) the effect contended for by the taxpayer would "lead to injustice and absurdity" and should be rejected. The deeming provisions in section 24 do not require one to assume that the actual settlor of the arrangement was not the settlor.'

123. In *Jenks v Dickinson,* Neuberger J (as he then was) considered the role of the court in correcting anomalies created by the literal wording of a tax provision by examining the relevant authorities. The rules of interpretation as summarised by Lord Donovan (at 746) in the Privy Council's decision in *Mangin v IRC* are set out at 860 of *Jenks v Dickinson*:

> 'First, [Lord Donovan] said that the words of the section were to be given their ordinary meaning. They were not to be given some other meaning simply because their object was to frustrate legitimate tax avoidance devices. Moral precepts were not applicable to the interpretation of revenue statutes. Secondly, one had to look merely at what was clearly said. There was no room for any intendment. There was no equity about a tax. Nothing was to be read in, nothing was to be implied. One could only look fairly at the language used. Thirdly, the object of the construction of the statute being to ascertain the will of the legislature it might be presumed that neither injustice nor absurdity was intended. If, therefore, an intended interpretation would produce such a result, and the language admitted of an interpretation which would avoid it, then such an interpretation ought to be adopted. Fourthly, the history of an enactment and the reasons which led to its being passed might be used as an aid to its construction.'

124. Neuberger J's reasoning in *Jenks v Dickinson* placed significance on the fact the statutory provision in question was a deeming provision, at 878:

> 'It appears to me that the observations of Peter Gibson J, approved by Lord Browne-Wilkinson, in *Marshall* indicate that, when considering the extent to which one can "do some violence to the words" and whether one can "discard the ordinary meaning", one can, indeed one should, take into account the fact that one is construing a deeming provision.'

125. Neuberger J continued at 878 by stating that in construing a deeming provision, it would involve 'identifying a limitation to the ambit of a deeming provision':

> 'This is not to say that ordinary principles of construction somehow cease to apply when one is concerned with interpreting a deeming provision: there is no basis in principle or authority for such a proposition. It is more that, by its very nature, a deeming provision involves artificial assumptions. It will frequently be difficult or unrealistic to expect the legislature to be able satisfactorily to proscribe the precise limit of circumstances in which, or the extent to which, the artificial assumptions are to be made. That difficulty is well demonstrated by the problem thrown up by, and the course of the litigation in, *Marshall* itself. Accordingly, while the rules of construction … apply equally to a deeming provision it is, at least in

> some circumstances, rather easier to identify a limitation to the ambit of a deeming provision than it is to the ambit of a provision which is not a deeming provision.'

126. At 879, the court's approach in addressing an anomaly was set out as follows:

> 'The fact that the major anomaly arises from the interrelationship of a deeming provision (if construed in a literal and unlimited way), an unusual set of facts, and legislation which is complex (even in the absence of the deeming provision) helps demonstrate why, particularly in such circumstances, it may be appropriate, as a matter of construction, to limit the apparently very wide effect of the deeming provision. … one is construing a provision, not merely as a matter of language, but also in its statutory context, having regard to the fairly plain overall legislative purpose, but bearing in mind also that the provision is a deeming provision, which brings into play the considerations raised in *Marshall*.'

127. In summary, the dicta from case law authorities in this regard are the following:

(1) In ascertaining the will of the legislature, it is presumed that neither injustice nor absurdity was intended, and if the language admitted of an interpretation which would avoid it, that ought to be adopted: *Mangin.*

(2) If a literal interpretation would lead to injustice or absurdity, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted: *Harding*.

(3) If the construction of a deeming provision would lead to injustice or absurdity, the application of the statutory fiction should be limited to the extent needed to avoid such injustice, unless such application would clearly be within the purposes of the fiction: *Marshall*.

(4) In some circumstances, it is easier to identify a limitation to the ambit of a deeming provision than it is to the ambit of a provision which is not: *Jenks.*

(5) Where an anomaly arises from the interrelationship of a deeming provision (if construed in a literal and unlimited way), an unusual set of facts, and complex legislation, it may be appropriate as a matter of construction, to limit the apparently very wide effect of the deeming provision: *Jenks*.

Whether a limitation to the ambit of the deeming provision

128. With these dicta in mind, I now consider whether the effect of the deeming provision under s 471(3) should be limited in the present case as a matter of statutory construction. For ease of analysis, I use the symbols X and Y to stand for the key aspects of the provisions under s 471 ITEPA as follows:

(1) This Chapter applies to a securities option acquired by a person where the right or opportunity to acquire the securities option is **X** (ie available by reason of an employment of that person or any other person).

(2) For the purposes of subsection (1) 'employment' includes a former or prospective employment.

(3) A right or opportunity to acquire a securities option [if **Y** obtains] (made available by the employer) is to be regarded for the purposes of subsection (1) as **X** (available by reason of an employment).

129. I agree with Mr Simpson that s 471 as a whole is definitional. Within the section provision itself, a hierarchy exists in the ranking of the subsections:

(a) The lead provision is under subsection (1);

(b) Subsections (2) and (3) exist 'for the purposes of subsection (1)';

(c) The cohort of subsections, including those under (4) and (5) cited earlier, all exist for the purposes of defining subsection (1);

(d) The phrase 'for the purposes of subsection (1)' is repeated in subsections (2), (3) and (4), making these subsections subordinate to (1);

(e) Seen in this light, the deeming provision under (3) ranks equal with subsections (2), (4) and (5), and is subordinate to subsection (1).

130. Subsection (3) defines by deeming: if **Y** (made available by a person's employer), then it is deemed to be **X** (by reason of employment). Can such a definition by deeming be limited in any way?

131. In *Steven Price* Judge Hellier's interpretation of the interrelationship between subsections (1) and (3) is as follows:

> '83. … It seems to us that subsection (3) is intended to have a wide effect. It is intended to avoid having to ask the factual question "did this come from the employment" when an employee gets something made available by his or her employer. …
>
> 84. But it does seem to us that some constraint on a wholly literal construction is intended. For example: A large bank will have employees. If that bank made available to a customer an option, it would on a literal construction of (3) make that option available by reason of any of its employees' employment – since it is made available "by a person's employer". If that is the case the customer's acquisition of the option would fall within (1) even though there is no real link to employment and the customer's exercise of the option would be taxable under section 476. If subsection (3) is read in this way then *the effect of (1) and (3) could be achieved simply by saying that the Chapter applies if an option is made available to anyone by a person who employs someone*. That is plainly not their purpose.
>
> 85. The purpose [of subsection (3)] seems to us to be the provision of an automatic link to employment if the recipient of the opportunity is an employee, and in other cases the requiring of an investigation as to whether or not there is in fact a link between the employment and the opportunity. *As a result we regard (3) as limited to the making available of an opportunity to an employee* by that employee's employer (or person connected with that employer).
>
> 86. This calls attention to the identification of the relevant right or opportunity. Subsection (1) refers to "the" right or opportunity to acquire; subsection (3) to "a" right or opportunity. They need not be the same. Thus *if the right or opportunity under which a person acquires is not the same right or opportunity as that made available to*

> *an employee then (1) will not be switched on by (3)*, although the more general question will remain under (1) as to whether in fact that person received the opportunity by reason of the employment.
>
> 87. Thus if, for example, one spouse is offered options by her employer and asks that the offer be made to the other, there will be no question that (3) and therefore (1) apply to the right or opportunity to acquire the options: the opportunity offered to the acquiring spouse is the same as the opportunity offered to the employee. But if the non employed spouse obtains an opportunity to acquire an option in the ordinary course of managing his investments, that opportunity will not be treated as having been, or have been, available by reason of his wife's employment at the bank.' (emphasis added)

132. If Judge Hellier's interpretation is correct, it would assist the appellant's case, in that subsection (3) is limited to interpreting 'the making available of an opportunity'. Reading this interpretation in context, I think Judge Hellier meant that subsection (3) 'is intended to avoid asking the question "did this come from the employment"' (X), and subsection (3) is limited to asking Y (did it come from the employer).

133. Furthermore, Judge Hellier considered that the application of subsection (1) is not identical to subsection (3), otherwise '*the effect of (1) and (3) could be achieved simply by saying that the Chapter applies if an option is made available to anyone by a person who employs someone*'. This observation has considerable force in terms of construing whether the deeming provision under subsection (3) is to be limited under specific circumstances.

134. Whilst the choice of the definite article in subsection (1) points to the right or opportunity in question, the use of the indefinite article in subsection (3) signals a generic categorisation. '*A* right or opportunity' under (3) as defined by deeming does not invariably define '*the* right or opportunity' under (1).

135. As discussed earlier, in most cases, by establishing Y (the making available of a right or opportunity) in subsection (3) would allow X (by reason of employment) to be deemed, thereby switching on X in subsection (1). Judge Hellier referred to this 'switching on' as 'an automatic link'.

136. However, other factors are at play to limit the wide and ranging effect of the deeming provision, namely:

> (a) that subsections (1) and (3) are not amalgamated into one provision;
>
> (b) the subordinate nature of subsection (3) to (1) in the hierarchy of statutory provisions under s 471;
>
> (c) the use of definite and indefinite articles in subsections (1) and (3) respectively points to the fact that within the statutory wording, 'the right' under subsection (1) need not be the same as 'a right' under subsection (3).

It seems to me, where there is an anomaly, the limitation in construing the effect of the deeming provision comes in the form of de-coupling (1) and (3).

137. On one interpretation, with an anomaly, the deeming effect of subsection (3) is to be limited in so far as subsection (1) is *not* automatically switched on by (3), thereby opens the way for a separate finding of fact in relation to X (re: whether the

right to acquire the option was by reason of employment) for the purposes of subsection (1). This would seem to be what Judge Hellier was considering as the '*other cases'* (ie anomaly cases) which require 'of an investigation as to whether or not there is in fact a link between the employment and the opportunity' at [85].

138. As Neuberger J remarked in *Jenks*, 'a deeming provision involves artificial assumptions', and in some circumstances, it is easier to identify a limitation to the ambit of a deeming provision. The example given in *Steven Price* of an employee of a bank having a right or opportunity to acquire a securities option in the bank made available to customers would seem to have identified a limitation to the ambit of the deeming provision under subsection (3).

139. The set of facts in the present case is 'unusual'. Had the Company not gone into difficulties that resulted in the rescue funding exercise in 2007, Mr Noble would have kept his Supplier Option granted in 2006, and would not have to litigate to have his tax liability assessed as capital gains. Had Mr Noble not happened to be the right person to steer the Company out of the difficulties, he would not have been caught by the deeming provision even if his 2006 Option had to be replaced by the 2007 Option.

140. The ambit of the deeming provision should be limited where the artificial assumption from deeming is at variance with the factual reason that gave rise to the right to acquire the option. As I have stated earlier, the 2007 Option was not made available by reason of Mr Noble's 'employment' (directorship) in Vermilion.

141. In the alternative, the deeming effect of subsection (3) can be limited by adopting Mr Simpson's submissions in relation to the interpretation of who (or what) had 'made available' the right or opportunity for Mr Noble to acquire the 2007 Option. The analysis of the underlying causes that led to the grant of the 2007 Option, and the economic mechanism whereby the 2007 option came to be granted, when viewed realistically, meant that Mr Noble's right to acquire the 2007 Option was not 'made available' by Vermilion as his 'employer'.

142. I have also considered whether Mr Simpson's alternative argument, that the 2007 Option was in substance the same as the 2006 Option, succeeds in limiting the interpretation of the deeming provision. For the following reasons, I dismiss the alternative argument:

(1) As a matter of fact, the 2006 and 2007 Options were not the same in substance: the 2006 option was effectively annulled by the execution of the 2007 Option agreement without any reference to its continuance in any form or substance in the 2007 Option agreement; the share register of the Company in the 2007 Option (of D, E and F Shares) was completely different from that in the 2006 Option (of A, B and C Shares); the relevant percentage of the 2007 Option at 1.5% was evidently different from the 2.5% of the 2006 Option; the 2007 Option was exercisable on F Shares which was totally removed from the 2006 Option category over which the right could be exercised.

(2) As a matter of law, the alternative argument is not relevant to considering how the deeming effect of s 471(3) can be limited. The subsection provides no scope for any findings of fact to be made as regards the option in question. The only relevant fact in relation to s 471(3) concerns whether the 'employer' was the grantor of the securities option.

143. For completeness, I have also considered whether the application of the deeming provision to give effect to HMRC's case 'is clearly within the purposes of the fiction': *Marshall*. Had the anomaly arisen in the present case as a result of an arrangement for tax avoidance purposes, then I would have considered the deeming effect of subsection (3) within the purposes of the fiction, and there would have been no need to consider the limitation of application of the deeming provision. The limitation of the construction of the deeming provision in the instant case to the extent as set out, does not contravene with the overall purpose of the ERS provisions, which is to tax the award of employment-related securities and options as earnings.

144. Finally, in *Steve Price* Counsel for the conjoined appeals submitted that 'it would not be striking a fair balance to deprive the appellants of their right to tax relief by applying legislation in a manner that was not intended by its enactment' and an infringement of the appellants' Convention rights under Article 1 of Protocol 1, see [101] to [105]. Mr Simpson has not made similar submissions and I make no comments in this respect.

Decision

145. For the reasons stated, the appeal is allowed. The 2007 Option is not an employment-related securities option for the purposes of section 471 of ITEPA 2003.

146. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

DR HEIDI POON
TRIBUNAL JUDGE

RELEASE DATE: 08 APRIL 2019

ANNEX

Relevant Legislation and Citation of Authorities

Income Tax (Earnings and Pensions) Act 2003

471 Options to which this Chapter applies

(1) This Chapter applies to a securities option acquired by a person where the right or opportunity to acquire the securities option is available by reason of an employment of that person or any other person.

(2) For the purposes of subsection (1) "employment" includes a former or prospective employment.

(3) A right or opportunity to acquire a securities option made available by a person's employer, or a person connected with a person's employer, is to be regarded for the purposes of subsection (1) as available by reason of an employment of that person unless—

(a) the person by whom the right or opportunity is made available is an individual, and

(b) the right or opportunity is made available in the normal course of the domestic, family or personal relationships of that person.

(4) A right or opportunity to acquire a securities option available by reason of holding employment-related securities is to be regarded for the purposes of subsection (1) as available by reason of the same employment as that by reason of which the right or opportunity to acquire the employment-related securities was available.

(5) In this Chapter—

"the acquisition", in relation to an employment-related securities option, means the acquisition of the employment-related securities option pursuant to the right or opportunity available by reason of the employment,

"the employment" means the employment by reason of which the right or opportunity to acquire the employment-related securities option is available ("the employee" and "the employer" being construed accordingly), and

"employment-related securities option" means a securities option to which this Chapter applies.

472 Associated persons

(1) For the purposes of this Chapter the following are "associated persons" in relation to an employment-related securities option—

(a) the person who acquired the employment-related securities option on the acquisition,

(b) (if different) the employee, and

(c) any relevant linked person.

(2) A person is a relevant linked person if—

(a) that person (on the one hand), and

(b) either the person who acquired the employment-related securities option on the acquisition or the employee (on the other),

are or have been connected or (without being or having been connected) are or have been] members of the same household.

(3) But a company which would otherwise be a relevant linked person is not if it is—

(a) the employer,

(b) the person from whom the employment-related securities option was acquired, or

(c) the person by whom the right or opportunity to acquire the employment-related securities option was made available.

473 Introduction to taxation of securities options

(1) The starting-point is that section 475 contains an exemption from the liability to tax that might otherwise arise under—

(a) Chapter 1 of Part 3 (earnings), or

(b) Chapter 10 of that Part (taxable benefits: residual liability to charge),

when an employment-related securities option is acquired.

(2) Liability to tax may arise, when securities are acquired pursuant to the employment-related securities option, under—

(a) section 446B (charge on acquisition where market value of securities or interest artificially depressed),

(b) Chapter 3C of this Part (acquisition of securities for less than market value), or

(c) section 476 (acquisition of securities pursuant to securities option).

(3) Liability to tax may also arise by virtue of section 476 when—

(a) the employment-related securities option is assigned or released, or

(b) a benefit is received in connection with the employment-related securities option.

(4) There are special rules relating to share options acquired under—

(a) Schedule 3 SAYE option schemes (see Chapter 7 of this Part),

(b) Schedule 4 CSOP schemes (see Chapter 8 of this Part), or

(c) enterprise management incentives (see Chapter 9 of this Part).

474 Cases where this Chapter does not apply

[Repealed by the Finance Act 2014, s 52, Sch 9, paras 1,6, 14.]

475 No charge in respect of acquisition of option

(1) No liability to income tax arises in respect of the acquisition of an employment-related securities option.

(2) Subsection (1) is subject to section 526 (. . . CSOP schemes: charge where share option granted at a discount).]

476 Charge on occurrence of chargeable event

(1) If a chargeable event occurs in relation to an employment-related securities option, the taxable amount counts as employment income of the employee for the relevant tax year.

(2) For this purpose—

(a) "chargeable event" has the meaning given by section 477,

(b) "the taxable amount" is the amount determined under section 478, and

(c) "the relevant tax year" is the tax year in which the chargeable event occurs.

(3) Relief under section 481 or 482 (relief for secondary Class 1 contributions or special contribution met by employee) may be available against an amount counting as employment income under this section.

[*(4) Repealed by the substitution of existing subs (1)-(4) by F 2004, s 85 and Sch 16, para 3(2).*]

(5) If the employee has been divested of the employment-related securities option by operation of law—

(a) income tax is charged on the amount determined under section 478, and

(b) the person liable for any tax so charged is the relevant person in relation to the chargeable event (see section 477(7)).]

(5A) An amount charged under subsection (5)(a) is treated for income tax purposes as an amount of income.

(6) This section is subject to—

section 519 (. . . SAYE option schemes: no charge in respect of exercise of share option by employee),

section 524 (. . . CSOP schemes: no charge in respect of exercise of share option by employee), and

section 530 (enterprise management incentives: no charge on exercise by employee of option to acquire shares at market value).

Sections 478 and 479 set out the amount of the charge to tax on exercising an option; ss 480 to 482 provide for certain deductions and reliefs.

483 Application of this Chapter where option exchanged for another

(1) This section applies if—

(a) the employment-related securities option (the "old option") is assigned or released, and

(b) the whole or part of the consideration for the assignment or release consists of or includes another securities option (the "new option").

(2) For the purposes of section 479(5) (amount of gain realised by assigning or releasing option) the new option is not to be treated as consideration given for the assignment or release of the old option.

(3) This Chapter applies to the new option as it applies to the old option.

(4) For the purposes of section 480(2) (consideration for acquisition of option) the amount of the consideration given for the acquisition of the new option is to be treated as being the sum of—

(a) the amount by which the amount of the consideration given for the acquisition of the old option exceeds the amount of any consideration given for the assignment or release of the old option, apart from the new option, and

(b) any valuable consideration given for the acquisition of the new option, apart from the old option.

(5) Two or more transactions are to be treated for the purposes of subsection (1) as a single transaction by which one option is assigned for a consideration which consists of or includes another option if—

(a) the transactions result in—

(i) a person ceasing to hold an option, and

(ii) that person or a connected person coming to hold another option, and

(b) one or more of the transactions is effected under arrangements to which two or more persons holding options, in respect of which there may be liability to tax under this Chapter, are parties.

(6) Subsection (5) applies regardless of the order in which the assignments and the acquisition occur.

Case law

The authorities are listed in the alphabetical order of the short case names used:

(1) The Collector of Stamp Revenue v Arrowtown Assets Limited [2003] HKCFA 52 ('**Arrowtown**')

(2) *Astall & Anor v Revenue and Customs* [2009] EWCA Civ 1010 ('***Astall***')

(3) *Attorney-General of Belize v Belize Telecom 5 Limited* [2009] 2 All ER 1127 ('***AG of Belize***')

(4) *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51; [2005] 1 AC 684 ('***BMBF***')

(5) *Black-Clawson International Limited v Papeirwerke Waldorf Aschaffenburg AG* [1975] AC 591 ('***Black-Clawson Ltd***')

(6) *British Telecommunications plc v Office of Communications 35 (Partial Private Circuits*) [2012] CAT53 ('***BT v Office of Communications***')

(7) *Harding v Revenue and Customs Commissioners* [2008] EWCA Civ 1164 (***Harding***')

(8) *Hochstrasser (Inspector of Taxes) v Mayes* (High Court – Dec 1957, Court of Appeal July 1958, House of Lords November 1959) 38 TC 673 ('***Hochstrasser***')

(9) *HMRC v Bank of Ireland Britain Holding Ltd* [2007] EWCA Civ 58 ('***HMRC v Bank of Ireland****')*

(10) *HMRC v Jones and another* [2011] EWCA Civ 824 ('***HMRC v Jones***')

(11) *Ingram and another v Commissioners of Inland Revenue* [1998] UKHL 47 ('***Ingram***')

(12) *Jenks v Dickinson (Inspector of Taxes)* [1997] STC 853 ('***Jenks v Dickson***')

(13) *Luke v Inland Revenue Commissioners* [1963] AC 557 ('***Luke v IRC***')

(14) *Mangin v Inland Revenue Commissioners* [1971] AC 739 (‘***Mangin v IRC***’)

(15) *Marshall (Inspector of Taxes) v Kerr* [1995] 1 AC 148 (‘***Marshall v Kerr***’)

(16) *Milton v DPP* [2007] EWHC 532 (Admin) (‘***Milton v DPP***’)

(17) *Pepper (Inspector of Taxes) v Hart* [1993] AC 593 (‘***Pepper v Hart***’)

(18) *The Pollen Estate Trustee Company Limited v HMRC* [2013] EWCA Civ 753 (‘***Pollen Estate***’)

(19) *R v A (No. 2)* [2002] 1 AC 45 (‘***R v A***’)

(20) *R v Inland Revenue Commissioners, ex parte Wilkinson* [2005] BTC 281 (***R v IRC ex p Wilkinson***)

(21) *William Reeves v HMRC* [2018] UKUT 0293 (TCC) (‘***Reeves v HMRC***’)

(22) *Robinson v Secretary of State for Northern Ireland and others* [2002] All ER (D) 364 (‘***Robinson***’)

(23) *Roome and Denne v Edwards (Inspector of Taxes)* [1982] AC 279 (‘***Roome v Edwards***’)

(24) *R v Secretary of State for the Environment, Transport, and the Regions, ex parte Spath Holme Limited* [2001] 2 AC 349; [2001] 1 All ER 195 (‘***Spath Holme***’)

(25) *Steele (Inspector of Taxes) v EVC International NV (formerly European Vinyls Corp (Holdings) BV)* [1996] STC 785 (‘***Steele v EVC’***)

(26) *Steven Price, John Myers and James Lucas v HMRC* [2013] UKFTT 297 (TC) (‘***Steven Price***’)

(27) *Swires (Inspector of Taxes) v Renton* [1991] STC 490 (‘***Swires v Renton***’)

(28) *Revenue and Customs Commissioners v Nicholas Trigg* [2016] UKUT 165 (TCC) (‘***Trigg***’)

(29) *UBS AG and DB Group Services (UK) Ltd v HMRC* [2016] UKSC 13 (‘***UBS***’)

(30) *Weston v Garnett (HMIT)* [2005] EWCA Civ 742 (‘***Weston v Garnett***’)