



Press Summary

25 October 2023

Commissioners for His Majesty’s Revenue and Customs (Appellants) v Vermilion Holdings Ltd (Respondent) (Scotland)

[2023] UKSC 37

On appeal from [2021] CSIH 45

Justices: Lord Hodge (Deputy President), Lord Lloyd-Jones, Lord Legatt, Lord Burrows, Lady Rose

Background to the Appeal

This case is concerned with the meaning of section 471 of the Income Tax (Earnings and Pensions) Act 2003 (“**ITEPA**”). That section sets out when an option to acquire securities (which includes shares in a company) is granted “by reason of employment” and therefore subject to income tax rather than capital gains tax.

In 2006, Vermilion Holdings Ltd (“**Vermilion**”) granted an option to Quest Advantage Ltd (“**Quest**”) to acquire shares in Vermilion (the “**2006 Option**”). By the end of 2006, it became clear that Vermilion was underperforming. As part of a rescue funding package, Vermilion and Quest agreed to amend the 2006 Option. In July 2007, Vermilion and Quest entered into a new option agreement (the “**2007 Option**”), under which Quest subscribed for a new class of shares in Vermilion and the 2006 Option expired.

In 2016, Quest transferred the 2007 Option to Mr Noble. Quest asked His Majesty’s Revenue and Custom (“**HMRC**”) to confirm that this transfer was subject to capital gains tax. HMRC disagreed, informing Quest that it was subject to income tax as it had been granted to Mr Noble because of his employment as a director of Quest.

Quest challenged HMRC’s decision in the First Tier Tribunal (the “**FTT**”). The FTT found that the 2007 Option was not granted by reason of Mr Noble’s employment. HRMC appealed this finding to the Upper Tribunal, which overturned the FTT’s decision. This was then subsequently appealed to the Inner House of the Court of Session, which, by majority, found in favour of Vermillon. HMRC has now appealed that decision to the UK Supreme Court.

Judgment

The Supreme Court unanimously allows the appeal. It holds that, under section 471(3) ITEPA 2003, Mr Noble is deemed to have acquired the securities option because of his employment as a director of Quest and it is therefore subject to income tax.

Reasons for the Judgment

The Court explains that the purpose of section 471 ITEPA 2003 is to define the circumstances in which the exercise of a securities option is subject to income tax instead of capital gains tax [21].

Section 471 does this in two ways. First, the grant of a securities option will be subject to income tax where it “*is available by reason of an employment of that person or any other person*”. To answer this question, a decision-maker must carefully consider the facts of each case to decide whether there is a causal connection between the person’s employment and the grant of the option [21] – [22].

However, that analysis is difficult and may give rise to disagreements among judges. To avoid such difficulties, section 471(3) creates a straightforward rule: if a person’s employer (or a person connected to that person’s employer) provides the employee with an option, that option is conclusively treated as having been made available by reason of their employment [24]. However, under that same section, a person will be exempt from this rule where both limbs of the following test are satisfied: (a) the person is an individual and (b) the option was granted in the normal course of the domestic, family, or personal relationships of that person.

In applying section 471(3) in this case the key question was: did Vermilion confer the 2007 Option on Mr Noble while it was his employer? The answer is that it did [21]. As Mr Noble did not satisfy the exception in section 471(3), there was no need to undertake a more detailed analysis under section 471(1). The option is therefore conclusively treated as having been granted to Mr Noble because of his employment and subject to income tax [24] – [33].

The Court also states that section 471(3) should not be applied in a way that would produce unjust, absurd, or anomalous results [23] – [26], [33]. However, the Court concludes that applying section 471(3) produced no such result in this case [26].

References in square brackets are to paragraphs in the judgment.

NOTE:

This summary is provided to assist in understanding the Court’s decision. It does not form part of the reasons for the decision. The full judgment of the Court is the only authoritative document. Judgments are public documents and are available at: [Decided cases - The Supreme Court](#)