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Case Notes

Vermilion Holdings Ltd – Sanity Restored

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The Supreme Court has released its decision in ***HMRC v Vermilion Holdings Ltd*** **[2023] UKSC 37**. HMRC were successful and the decision confirms an orthodox approach to the deeming provision in s.471(3) ITEPA which treats securities options as being employment-related.

In short, the result means that whenever the right/opportunity to acquire securities or a securities option is made available to an employee by an employer or a person connected with them, it will automatically be treated as "employment-related" unless one falls within the specific exception where the employer is an individual and the provision is made "in the normal course of the domestic, family or personal relationships". As the conclusion of the decision states at [33]:

> *"The statutory provision makes clear that if an employer makes available to an employee a securities option, that option will be treated in the employee's hands as an employment-related securities option and taxed accordingly."*

In other words, there is no further soul-searching required as to whether the outcome under s.471(3) is the result intended by Parliament and/or could be said to be anomalous or absurd.

By extension the reasoning will also apply to the almost identical test in s.421B(3) ITEPA (employment-related securities). Further, it also removes doubt as to the effect of similar deemings in the Benefits Code.

The underlying facts

Mr Noble was a consultant who provided advice to technology companies on fundraising, business growth, acquisitions and divestments though a company, Quest Advantage Ltd (**"Quest"**) which he part owned with a Mr Carnegie. As a fee for some work on a fundraising for Vermilion Holdings Ltd

(**"Vermilion"**) in 2006, Quest received an option over the shares in Vermilion (**"the 2006 Option"**) as a nominee for Mr Noble.

By 2007 Vermilion was in financial difficulty and a rescue funding package was agreed. However, it was a precondition of such funding that (i) Mr Noble be appointed as executive chairman and (ii) that Quest's previous option was to be amended – in the end it was cancelled and a new option was granted by Vermilion on 2 July 2007 to Quest as nominee for Mr Noble (**"the 2007 Option"**).

In 2016, when it was proposed that Vermilion's shares would be sold to another accompany, the 2007 Option was novated from Quest to Mr Noble. Mr Noble then exercised the 2007 Option. The novation itself was not the focus of argument presumably because Quest was previously holding as a nominee for Mr Noble.

The issue in the case was whether the 2007 Option was an employment-related securities option within the meaning of s.471 ITEPA. The appeal was made by Vermilion against a r.80 determination for PAYE and a s.8 decision for NICs.

The decisions below

The appellate story could be summarised as follows:

(1) First-tier Tribunal decision [2019] UKFTT 230 (TC): securities option held not be to employment-related since:

- s.471(1) was not met (since employment was not the actual cause); and
- s.471(3), whilst prima facie satisfied, was held not to treat the securities option as employment-related since either:
  - the result was "an anomaly" and so the deeming effect of s.471(3) had to be limited where the result would be "at variance" with the reality that the option was not as a matter of actual fact employment-related (see [140]); or
  - alternatively, one was required to interpret s.471(3) on the basis that the 2007 Option was not provided by Vermilion "as employer" (see [141]).

There appears to have been some confusion before the FTT. HMRC (using a litigator) only advanced a case in their skeleton on s.471(1) but the FTT only really addressed s.471(3) substantively (addressing s.471(1) as part of its analysis only for s.471(3) purposes). Permission to appeal thereafter was granted on both s.471(1) and (3).

(2) Upper Tribunal decision [2020] UKUT 162 (TCC): securities option held to be employment-related under s.471(1) and so there was no need to consider s.471(3). The UT found that employment was an operative cause of the grant of the 2007 Option since employment as a director was effectively a condition of the 2007 Option being granted (see [81]).

(3) Court of Session (Inner House) decision [2021] Scot CS CSIH 45: a majority of the Inner House (the Lord President, Lord Carloway, dissenting on both points) held that:

- s.471(1) was not satisfied either because:
  - Lord Malcolm: employment was not an operative cause of the grant of the 2007 option (merely stipulating employment as a condition was not enough) and on a realistic view of the facts Mr Noble did not "acquire something which he did not already have".

    - Lord Doherty: the UT was not entitled to interfere with the FTT decision that the pre-existing 2006 Option was (implicitly) the only operative cause of the 2007 Option.
- s.471(3) was not satisfied either because s.471(3) was not a separate basis for finding that a securities option was employment-related once it had been positively established that the securities option was not employment-related under s.471(3). In the words of Lord Malcolm this was because "Parliament did not intend that tax would be payable on the basis that something should be deemed to have occurred by reason of an employment when it has been established that the employment was not a reason for it". For Lord Doherty it was because there was "no real" link between the employment and the 2007 Option and this was sufficient to prevent s.471(3) applying.

The Supreme Court decision

Lord Hodge gave the only judgment (with whom the rest of the court agreed). In terms of the test in s.471(1), since the court did not need to decide this, the commentary on this is relatively limited. The approach of Oliver LJ in *Wicks v Firth* appears to be endorsed (see [12]-[13] and [22] of Lord Hodge's judgment) but no further guidance is given on how to apply such a test to a case such as that before the court.

In terms of s.471(3), Lord Hodge's approach is essentially built on the dissenting judgment of the Lord President (Lord Carloway) below – i.e. to identify the purpose of the deeming provision in s.471(3) consistent with the guidance of the Supreme Court in the earlier case of ***Fowler v HMRC*** **[2020] UKSC 22**:

> *"It is not difficult to ascertain the purpose of the deeming provision in section 471(3). The causation questions which can arise under section 471(1) may be difficult and may give rise to disagreement among judges as has occurred in this case. To avoid such difficult questions, subsection (3) creates a bright line rule: if a person's employer (or a person connected to that person's employer) provides the employee the right or opportunity to acquire a securities option, that right or opportunity is conclusively treated as having been made available by reason of the employment of that person (unless subsections (a) and (b) apply). This involves a straightforward examination of the agreement or transaction to ascertain who conferred the right or opportunity. The question is not concerned with the reason why the employer conferred the right or opportunity."*

Given that Vermilion had conferred the 2007 Option, that was the end of the matter. Lord Hodge emphasised that one should start with s.471(3) since the whole point of it is to make the more complicated enquiry under s.471(1) unnecessary if it is satisfied. That is why the court held that both the FTT and the majority of the Inner House were misguided in finding that the result was absurd or anomalous:

> *"It put the cart before the horse: the purpose of the deeming provision is to avoid the decision-maker having to carry out the section 471(1) assessment. There is no anomaly here."*

That dealt with the first of the FTT's approaches (at [140] of its decision). The alternative ([141] of the FTT decision) was also rejected since it wrongly brought in a question of causation (i.e. a "why" question) into s.471(3) when such a question was only relevant to s.471(1). In short s.471(3) is a "who" question (i.e. who is the person providing the securities option, is it the employer or person connected with them?) and is not interested in the reasons why the employer is providing the securities option.

After having reached these main conclusions, the judgment (unusually for the Supreme Court) then went on to address the reasoning of the FTT in the earlier case of ***Price v HMRC*** **[2013] UKFTT 297 (TC)** due to the fact that this was the focus of discussion in both the FTT and the Inner House who in Lord Hodge's view had misread the decision. The discussion here concerns an ambiguity in the wording of s.471(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,"*

In *Price*, Judge Hellier at [84] commented that on a "wholly literal construction" this would mean that whenever an employer (e.g. a large bank) provided an option to anyone else (e.g. a non-employee) this would still be within the deeming. That would obviously be absurd and perhaps not even a proper "literal construction". The solution to Judge Hellier at [85] was that s.471(3) is "limited to the making available of an opportunity to an employee by that employee's employer (or person connected with that employer)". This approach appears to be endorsed by Lord Hodge at [31]-[32].

What Lord Hodge was clear about was that *Price* was not suggesting that the deeming ought not to apply where an employee is provided with a securities option on the same terms as a member of the general public – as is now clear from the Supreme Court decision, this clearly would be caught. Confusion in respect of *Price* was different in the FTT and the Court of Session (which is not worth setting out here) but in respect of the latter the reasoning was not assisted by HMRC's concession recorded by Lord Doherty at [66]:

> *"The fact that they were employees of the bank would have nothing to do with their receiving the offer, which would come to them because they were customers. Senior counsel for the respondents accepted that the right or opportunity would not have been made available by their employer. In his submission that was because there would be no 'real link' between the fact of their employment and the right or opportunity (cf Price, para [84])."*

This concession appears to have been abandoned before the Supreme Court but this is not recorded in the judgment of Lord Hodge.

Comment

It is quite rare for a case to reach the Supreme Court where the right result seems so obvious. The decision provides welcome clarity on the deeming in s.471(3) and by extension s.421B(3) and the provisions of the Benefits Code. The only reason why the case went so far is that the majority of the Inner House found it irresistible to make bad law out of a hard case. This is all the more surprising given the clear dissenting judgment of the Lord President in the Court of Session.

In terms of the scope of s.471(3), the limitation on it only applying where the making available of the opportunity is to the employee (as opposed to anyone else) is the sensible and obvious limitation on the scope of the deeming. However, this does not mean that it can be easily side-stepped since:

(1) The question is about the making available of an opportunity as opposed to the grant of the option itself – so, for example, if an employee simply directs the grant of an option to their spouse/civil partner this will still fall within s.471(3); and

(2) In any event, s.471(1) would likely be satisfied in a "redirection" case.

That said, since s.471(3) only applies where the recipient of the right/opportunity is an employee, this will not apply to prospective or former employees. The extension of "employment" in s.471(2) to include former/prospective employments only applies to s.471(1). The same applies for s.421B. However, one needs to be alive to the fact that matters are different in the Benefits Code depending on which provision one is looking at.

Advisers will also need to be alert to the consequences of a strict application of the deeming rule in s.471(3)/s.421B(3). Now we know that there is no "purpose" or "reality" based let out from the deeming, caution will need to be taken in terms of any dealing between employee and employer (or a person connected with the employer).