FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2021] CSIH 45
XA44/20

Lord President
Lord Malcolm
Lord Doherty

OPINION OF LORD CARLOWAY, the LORD PRESIDENT

in the appeal under section 13 of the Tribunals, Courts and Enforcement Act 2007 by

VERMILION HOLDINGS LIMITED

Appellants

against

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Appellants: Simpson QC, Gilson Gray LLP
Respondents: Ghosh QC, R MacLeod; Office of the Advocate General

20 August 2021

Introduction

[1] The appellants challenge the decision of the Upper Tribunal (Tax and Chancery Chamber), dated 27 May 2020, that the grant of an option for 1.5% of their equity to one of their directors was an employment related securities option in terms of section 471 of the Income Tax (Earnings and Pensions) Act 2003, and thus chargeable to income tax and subject to national insurance contributions. The UT reversed the decision of the First-tier Tribunal dated 8 April 2019. The appeal raises a sharp question about the application of section 471 and the deeming provisions of sub-section 471(3) in circumstances in which,

according to the appellants, the option had simply replaced an earlier one which, it was accepted, had not fallen within the section.

Section 471

[2] The Income Tax (Earnings and Pensions) Act 2003 provides:

> "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....
> …
> (3) 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 unless…".

Facts

[3] Vermilion Software Ltd was incorporated in 2003 by four software engineers who had previously worked for an investment bank. They produced and marketed a software product (a client reporting solution) to the asset management industry. Marcus Noble, through the vehicle of his company, namely Quest Advantage Ltd, advised technology businesses on fundraising, business growth, acquisitions and divestments. He often worked alongside the management of a company as a director and investor. In about 2005/2006 he was approached by Iestyn Williams, who considered that there was potential in Vermilion Software, but they needed additional capital.

[4] In early 2006, an equity fund raising exercise took place. The appellants were incorporated and became the holding company of Vermilion Software. Dickson Minto WS were instructed as the appellants' legal advisers. Quest and an accountant and business adviser, namely Scott Carnegie, produced a business plan and a financial projection. About

£2.5m was raised. This resulted in there being four shareholder directors with 55% of the equity in A and B shares. There were also private equity holders of A, B and C shares and a "consortium" group with B and C shares only. The latter two categories held the remaining 45% of the equity.

[5] Instead of rendering fees, Dickson Minto (through a nominee company) and Quest were each granted options to acquire 2.5% of the appellants' ordinary share capital. The options could be exercised in certain circumstances, including the sale of the appellants. A partner at Dickson Minto explained the reason for this to the FtT. The deal had involved much more work than had been anticipated. The new investors did not wish their funds to be spent on legal and advisory fees. The options were effectively payment for services rendered "in the process of the fundraising exercise, which terminated in a successful financing being closed out on 1 February 2006".

[6] The option agreement between the appellants and Quest was signed by one of the appellants' directors and Mr Noble, as a director of Quest, on 1 February 2006. It provided that Quest would be granted:

> "2.1 … an option … to subscribe at nominal value for… such number of Ordinary Shares as represent the Relevant Percentage (up to a maximum of 2.5 per cent) … of the issued equity share capital …."

No consideration was payable for the grant of the option. It could be exercised only as a whole and within 10 years (cl 4.1 and 4.3).

[7] By December 2006, the appellants were in serious financial difficulty. Mr Williams, who had invested as part of the fundraising exercise, initiated remedial action. He asked Mr Noble for his view. This was that the appellants' commercial prospects were very good, but that the business was being poorly managed. Further investment and changes in

management leadership were advised. Everyone's shares, including those in the options, ought to be "diluted" and further capital should be injected.

[8] A "Summary Report of Principal Legal Terms Relating to Rescue Funding Proposal", dated 9 March 2007, was prepared by Dickson Minto. The consortium investors would provide further capital of £0.7m in stages according to a series of equity milestones. The other shareholders were to be given an opportunity to subscribe for additional shares by the first milestone in May 2007. The arrangement turned the consortium investors into the major shareholders. The managing director was to resign and the A shares of the four existing shareholder/directors were to be converted into ones with no voting rights. Their equity was to be diluted and their remuneration reduced. Mr Noble was to become a director and the executive chairman. He would, in the following 12 months, devote not less than 1 to 2 days per week to the appellants' business in return for £4,167 per month. His appointment was effective from 16 March 2007.

[9] Quest's and Dickson Minto's existing options were to be cancelled or amended, whereby their percentage values would be reduced to a maximum of 1.5% of the issued ordinary share capital. Specifically, the Summary Report provided:

> "5. Treatment of Existing Options
>
> At present, the Company is party to option agreements … which, conditional upon the Company achieving the First Equity Milestone, it is proposed are to be treated as follows.
>
> (i) The Company has outstanding options granted to each of [Dickson Minto] and [Quest] … under 2 separate option agreements, each in respect of up to 2.5% of the issued equity share capital … on the occurrence of an "Exit" … 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."

[10] The UT explained (at para 11) the reason for Mr Noble and Dickson Minto agreeing to a reduction in the value of their options as follows:

> "The 2006 Option and the Dickson Minto Option were dilution proof as they referred to a percentage of equity not a fixed number of shares. The other investors considered it unfair that Mr Noble and Dickson Minto would be getting a "free ride" if their options were not diluted along with the rest of the shareholders. Mr Noble and Dickson Minto conceded to this otherwise their options would have become worthless."

As part of the refinancing, Mr Carnegie was appointed as finance director on similar terms to Mr Noble, but he was not granted an option.

[11] The option provision was implemented by the grant of a new option, rather than a variation of the existing agreements. The new option for up to 1.5% of equity in the appellants was agreed between the appellants and Quest on 2 July 2007. The agreement provided that:

> "2.1 The [appellants] hereby grants to the Optionholder an option … to subscribe for … such number of Ordinary Shares as represent the Relevant Percentage (up to a maximum of 1.5 per cent) … of the issued share capital … of the [appellants] …
>
> 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 …".

[12] In November 2016, the appellants were sold to a company listed in the United States of America. By that point, in terms of a novation agreement signed by Mr Carnegie on behalf of Quest on 9 June 2016, Mr Noble had replaced Quest as the "Existing Optionholder" under the new 2007 Option. This was in anticipation of the exercise of the option following on the sale. That exercise resulted in a payment to Mr Noble of £636,238. The respondents ultimately determined, relative to the tax year 2016/17, that this gave rise to a charge to income tax of £285,148.76 and class 1 National Insurance contributions of £100,709.98.

An exchange of views

[13] On 18 November 2016, the appellants sought a non-statutory clearance that the 2007 Option was subject to capital gains rather than income tax because neither option was an employment related securities option in terms of section 471. This was albeit that, according to the appellants (at p 3 "In Summary"):

> "… On a literal view of s471(3), the fact that he was already a director would mean the [2007 Option] was an employment related option, with resulting income tax consequences viz that the market value of the shares acquired, less the price paid, would be taxed as employment income and PAYE/NI would apply as the shares would be readily convertible assets. This seems incorrect to us in the particular circumstances here, as it ignores the fact that the option merely replaces the existing right which was not in any way employment related. Furthermore the replacement right attracts a substantially reduced potential benefit...".

[14] The respondents disagreed. On 14 December 2016, they replied that, whereas the 2006 Option was not employment related, the 2007 Option was. The grant of the 2007 Option did not fall under any of the exceptions in sub-section 471(3), and thus its exercise was a chargeable event in terms of section 477. There was further correspondence before, on 3 August 2017, the respondents essentially repeated their stance.

[15] Decision notices were duly issued relative to both PAYE and national insurance. A review was sought. The respondents' conclusion on 27 September 2017 (at p 3) remained the same, *viz.*:

> "S471 applies … because the [2007 Option] was provided to Mr Marcus Noble by reason of his employment with [the appellants].
>
> … I acknowledge that the [2006 Option] was not employment related. … Mr Noble was a director at the time of the [2007 Option], and thus the share option is employment related unless S471 (3) (a) and (b) apply. … Mr Marcus Noble had access to [the 2007 Option] because of his role as director and hence the share option is employment related."

First-tier Tribunal ([2019] UKFTT 0230 (TC))

[16] The appellants appealed to the FtT. In their statement of case, the respondents again contended that the 2007 Option was a securities option made available by Mr Noble's employer. Sub-section 471(3)(a) and (b) did not apply, to exempt it from taxation. In their written argument, they stated that "HMRC decided that the gain fell within the provisions of Chapter 5 Part 7 ITEPA 2003 by virtue of s. 471 (1) ITEPA 2003, which states …". What followed was a quotation of sub-sections (1) to (4) of a previous version of section 471 which had ceased to apply from 31 August 2003.

[17] The FtT judge rejected the appellants' submissions that Parliamentary materials ought to be examined in order to ascertain the meaning of section 471. There was no suggestion that the wording of the section was ambiguous or obscure. The appellants had recognised that the 2007 Option was caught by the clear meaning of a literal interpretation of the section. There was no absurdity. The judge commented that an emphasis on a purposive, as distinct from a literal, construction suggested "a dichotomy which is false rather than real". In the vast majority of cases, the purpose of a provision, as discerned from the words used, would be the same as its literal meaning. There was no good reason for interpreting the purpose of section 471 by looking outside its wording. The purpose of part 7 of the 2003 Act was not in doubt. It was to bring the grant of options, which were employment related, into the income tax regime.

[18] The FtT judge noted that sub-section 471(3) was a specific anti-avoidance provision. It was a deeming provision, on which the respondents relied. It was common ground that neither of the exceptions in sub-section 471(3)(a) and (b) applied. The only issue was whether the 2007 Option fell within sub-section 471(1). The judge examined the meaning of the phrase "by reason of an employment" in sub-section 471(3) under reference to *Wicks* v

Firth [1982] 1 Ch 355 (at 363; see [1983] 2 AC 214). The judge held (at para 105) "As a matter of fact" that Mr Noble's appointment as a director "was not the *causa* for the grant of the 2007 Option". It had been granted for the same reason as that to Dickson Minto, *viz.* the existence of the 2006 Options. The right to acquire the 2007 Option emanated from the right under the earlier option.

[19] The FtT judge went on to consider the respondents' argument that the deeming effect of sub-section 471(3) brought the option within section 471's ambit. Her view was that sub-section 471(3) created a presumption. It meant that the question was simply whether the right to acquire the 2007 Option was "made available" by the appellants. That question had to be answered in the affirmative because the appellants were the grantors of the 2007 Option. The judge thought that an anomaly resulted from this. She had held that the 2007 Option was not within the scope of sub-section (1), as it had not been caused by reason of employment, yet it was nevertheless to be deemed to have been so caused by sub-section (3). This would lead to an injustice.

[20] The FtT judge explored the interpretation of deeming provisions (*Harding* v *Revenue and Customs Commissioners* [2008] STC 3499, para 51; *Marshall* v *Kerr* [1995] 1 AC 148, at 164 and 168 to 170; *Jenks* v *Dickinson* [1997] STC 853, at 860, 878 and 879; *Mangin* v *Inland Revenue Commissioners* [1971] AC 739, at 746). Where an anomaly arose in the context of a deeming provision, it may be appropriate to construe the provision in order to limit what was otherwise its "very wide effect".

[21] Section 471 as a whole was "definitional" and hierarchical. Sub-section (3) was subordinate to the "lead provision" of sub-section (1). The question was whether it could be limited in effect so that a securities option which was granted by reason of an employment would not always result in it being made available by the employer. Under reference to

Price v *Revenue and Customs Commissioners* [2013] UKFTT 297 (TC), the FtT judge concluded that, where there was an anomaly, "the limitation … comes in the form of de-coupling (1) and (3)" to prevent sub-section (3) automatically switching on sub-section (1) (*ibid*, para 85). The present facts were sufficiently unusual as to justify this construction. If the appellants' financial difficulties had not arisen, and Mr Noble had not happened to be the right person to "steer the Company out of the difficulties", the 2007 Option would not have been caught by sub-section (3). A limitation was to be applied "where the artificial assumption from deeming is at variance with the factual reason that gave rise to the right to acquire the option". This criterion was met. The 2007 Option was not made available by reason of Mr Noble's employment by the appellants.

[22] An alternative reason given by the FtT judge was that, in terms of sub-section (3), the 2007 Option had not been "made available" by the appellant as Mr Noble's employers. It had been made available by Mr Noble himself, in giving up 40% of the 2006 Option, and/or the other investors who had agreed to the rescue package.

Upper Tribunal (Tax And Chancery Chamber) ([2020] UKUT 162 (TCC))

[23] In their application for permission to appeal to the UT, the respondents did not rely on sub-section (1) alone. The grounds of appeal lodged with the application read:

> "1. … the Tribunal erred in its approach to interpreting section 471 by treating section 471(3) as subordinate to section 471(1). These subsections apply to different and distinct circumstances. The application of section 471(1) is not dependent on determining who made available the right or opportunity. In contrast section 471(3) is dependent on the right or opportunity being made available by an employer … The consequence of either being met is that the right or opportunity will be subject to Chapter 7 of ITEPA."

In their skeleton argument, the respondents argued that the 2007 Option was made available by reason of Mr Noble's employment because the FtT: (i) unequivocally found that the

[appellants] had made available the 2007 Option…; and (ii) accepted that Mr Noble was an employee. The FtT had been bound to hold that the 2007 Option came within the ambit of section 471(1) as being "available by reason of an employment".

[24] The UT first decided what the respondents were entitled to argue in the appeal. The appellants had protested that the respondents' case before the FtT had been solely that the 2007 Option had been made available by the appellants as Mr Noble's employer and that neither of the exceptions applied (s 471(3)), whereas in their skeleton argument they contended for the first time that it had been made available "by reason of an employment" (s 471(1)). Having regard to the inclusion of section 471(1) specifically in the response to the clearance application on 14 December 2016 and at various points thereafter, the UT concluded (para 56) that it was in the interests of justice to consider this argument, which they went on to accept.

[25] In terms of sub-section (1), all that was required was that the option was acquired by a person. Nothing turned on the identity of the issuer. The respondents had not accepted before the FtT that the 2007 Option emanated from the 2006 Option. The FtT judge had been wrong to characterise that finding as a "matter of fact". It was a matter of mixed fact and law consisting of the application of the law to the facts and circumstances of the case. The judge had erred by failing to apply *Wicks* v *Firth* whereby the words "by reason of an employment" in sub-section 471(1) were to be given their ordinary meaning in the circumstances of the case. The employment need not be the sole reason for the option. It was sufficient that the employment was a condition of the benefit being granted. The test in *Wicks* v *Firth* had been met.

[26] Mr Noble's employment as a director had been an operative cause. It had been a condition of the 2007 Option being granted. The 2007 Option had been made available by

reason of Mr Noble's employment. The 2006 Option had become worthless. The 2007 Option was not part of the value already earned through consultancy services, which had been provided in Mr Noble's previous capacity as an adviser to the appellants. That value had already been lost. After the 2007 Option had been granted, its value had substantially increased. The rescue package was conditional on Mr Noble becoming executive chairman, devoting not less than 1 to 2 days per week to the role, and the 2006 Option being "amended/cancelled". The appellants and Mr Noble had chosen to issue a new option rather than to amend the existing one. The UT had to proceed on the basis of what had been done and not what could have been done. There was more than one reason for the grant of the 2007 Option. One was that the 2006 Option could no longer continue in its current form. Another was that it was part of a rescue package, including the employment of Mr Noble. His employment was a condition of the granting of the 2007 Option.

[27] It was not necessary to consider the alternative argument which was based on sub-section (3). The option fell within sub-section (1).

Submissions

Appellants

[28] Mr Noble's existing rights had been reduced by the transaction through which he had acquired the 2007 Option. If there had been no such reduction, his gain would have attracted capital gains tax. On a purposive interpretation of section 471, applied to the facts viewed realistically (*UBS* v *Revenue and Customs Commissioners* [2016] 1 WLR 1005, paras 61-68), the UT erred in finding that the 2007 Option was caught by that provision. The FtT judge correctly established that this would be unjust or absurd.

[29] It had been common ground before the FtT that the 2007 Option had not been acquired "by reason of an employment". The UT were wrong to permit the respondents' argument on the direct application of sub-section (1). That argument had been included for the first time in the skeleton argument before the UT. In allowing this ground to be argued, the UT had misunderstood the parties' correspondence. The response to the clearance request had referred only to sub-section (3). The exceptions in sub-section (3) did not apply to the provision in sub-section (1). The respondents' skeleton argument before the FtT did not identify sub-section (1) as the basis for their argument, particularly as the words quoted were out-of-date. The respondents' application for permission to appeal to the UT had referred solely to the deeming provision having been met. Their Notice of Appeal to the UT did not add a case based on sub-section (1). This case came too late. Permission had not been granted on whether the 2007 Option was within sub-section (1), read alone.

[30] The 2007 Option had not been made available by reason of Mr Noble's employment with the appellants (*Wicks* v *Firth* [1982] 1 Ch 355 at 363 and 371). Apart from specific legislation, an employee's profit from the sale of shares was not received from his or her employment (*Abbott* v *Philbin* [1961] AC 352, at 367). The test of "by reason of an employment" could not be satisfied unless there was, as a matter of fact, a causal relationship between the benefit and the employment (*Wicks* v *Firth*). There had to be legal causation. That required to be established by asking: "what is it that enables the person to receive the benefit in question?" The test was not "conditional on" employment but whether the option was "available by reason of an employment".

[31] The reduced option and Mr Noble's appointment were causes of the refinancing. Analogous to *Mairs* v *Haughey* [1994] 1 AC 303, the reduced option was not a cause of the appointment. It involved the giving up of an existing right. The FtT judge found in fact that

the 2007 Option was a dilution of the 2006 Option. The UT were wrong in holding that the grant of the 2007 Option was subject to the fulfilment of other conditions, including Mr Noble's employment. The 2006 Option, which was the reward for Mr Noble's services as a consultant, was found to be the "sole reason" for the grant of the 2007 Option. He could not have acquired it without having already held the 2006 Option. Dickson Minto had acquired an identical option. Mr Carnegie had been appointed as a director as a condition of the refinancing, but had not been granted an option. The UT erred in placing significance on the cancellation of the 2006 Option. The FtT judge had made a clear finding that the cancellation merely fulfilled the commercial requirement that the 2006 Option was to be reduced to a maximum of 1.5% (see *Charman* v *Revenue and Customs Commissioners* [2020] STC 1907). The UT had not been entitled to interfere with the FtT judge's finding on factual causation. In any event, their view was wrong.

[32] There was no precedent on the meaning of "made available by" in sub-section (3). The words should be given their ordinary meaning. What had to be available was not the acquisition of the option itself but the right or opportunity to acquire it. The FtT judge found that the 2007 Option had not been made available by the appellants. There was no reason to disturb this finding, even if it were a finding of mixed fact and law. The judge found that the right to acquire the 2007 Option was made available by the appellants. This was an inference from the parties to the option agreement being the appellants and Mr Noble. The appellants were the grantors, but identifying the grantor of an option was not the test in sub-section (3). No inference, that the right to acquire the 2007 Option had been made available by the appellants, could be drawn. The primary fact, that the right to acquire the 2007 Option was that Mr Noble held the 2006 Option, precluded the application of sub-section (3).

Respondents

[33] Reliance on section 471(3) was foreshadowed in the pre-litigation correspondence, the skeleton argument before the FtT, the application to the FtT for permission to appeal to the UT and the appeal lodged in the UT. The appellants had notice of the respondents' position that section 471 could be interpreted under reference to sub-section (1) alone. Even if the UT were wrong in that respect, this ground did not depend upon any new findings of fact (*Murray Group Holdings* v *Revenue and Customs Commissioners* 2016 SC 201, at para [39]).

[34] The respondents were entitled to succeed either by a pure application of section 471(1) or through the application of sections 471(1) with (3). Applying sub-section (3) before sub-section (1) did not change the result.

[35] Section 471 prescribed the conditions which brought an option within the ambit of Chapter 5 of Part 7 of the 2003 Act. The ordinary meaning of the provision was that, when a person acquired an option and the right to acquire it was available by reason of that person's employment, sub-section (1) was engaged. This accorded with the contextual interpretation of the ordinary meaning of the words used (*R* v *Secretary of State of the Environment, Transport and the Regions ex parte Spath Holme* [2001] 2 AC 349 at 396). The UT had correctly applied *Wicks* v *Firth* ([1982] 1 Ch 355 at 363 and 369 to 371) and *Charman* v *HMRC* (paras 61-75, 85-88, 115-119). Where the right to acquire an option was made available by reason of a person's employment, it was both unnecessary and illegitimate to look beyond the cause in order to give effect to section 471. The FtT judge had failed to apply *Wicks* v *Firth* by not considering whether there was any link between Mr Noble's employment and the grant of the 2007 Option. The simplest approach to determining whether the grant of the 2007 Option was "by reason of an employment" was to ask whether

the 2007 Option would have been granted to Mr Noble if he had not become a director. It would not have been. The refinancing and restructuring of the appellants was conditional on Mr Noble taking over as executive chairman. The 2007 Option was not a reduction of the 2006 Option. The question was whether one of the operative causes of the 2007 Option was Mr Noble's directorship. The answer, as a function of logic, was that it was.

[36] The FtT judge's reasoning on section 471(3) was flawed. She correctly recognised that the deeming provision in *Wicks* v *Firth* dispensed with the need to inquire into causation or intention. She found that, once there was a finding that an employer had made available a right to acquire an option, the deeming provision in section 471(3) applied. The judge asked herself whether the right to acquire the 2007 Option had been made available by the appellants; answering that they granted the 2007 Option. If she had concluded her analysis there, she would not have fallen into error.

[37] The FtT judge then decided that there was an anomaly which required a limitation on sub-section (3). Her analysis was wrong for a number of reasons. There was no anomaly between a "statutory fiction" and the judge's view of the facts, or at least none which required the court to seek to restrict the effect of the deeming provision. Its purpose was to curtail any factual investigation when considering whether the option had been provided "by reason of an employment". It did so by creating an "irrebuttable presumption" (*Price* v *Revenue and Customs Commissioners*, paras 83 to 85; *Norman* v *Revenue and Customs Commissioners* [2015] UKFTT 0303 (TC), paras 81 and 82). The deeming provision was not designed to create a fiction whereby certain facts were deemed to be different from the real position since in many cases the same result was achieved regardless of the route, ie sub-section (1) or (3). The whole point of a deeming provision was counterfactual. It did not matter that a judge did not like it. It was what Parliament

intended and had to be applied unless there was an absurdity. The provision was there in order to avoid a debate on causation. The point was that what might not be an emolument was brought into the income tax regime, provided that there was a real link between the option and the employment. The judge's decision had the effect of rendering the deeming provision devoid of content, since it would be disapplied whenever a difference arose between the factual analyses under sub-sections (1) and (3).

[38] The judge's summary of the authorities on deeming provisions concentrated on the circumstances in which a limiting construction should be adopted. It failed to identify the purpose which was served by the deeming provision. The construction adopted was not based on any assessment of purpose (*Fowler* v *Revenue and Customs Commissioners* [2020] 1 WLR 2227, para 27). The reliance on the discussion in *Price* v *Revenue and Customs Commissioners* failed to recognise the distinct factual context in that case. The FtT judge had not reverted to the wording of sub-section (3) in setting out her alternative construction. She had simply refused to "switch on" that provision as a result of a perceived anomaly. Her interpretation did not clarify what the anomaly was.

Decision

[39] The UT cannot be faulted for permitting argument on the applicability of sub-sections 471(1) and (3). Both required to be considered in determining whether income tax and national insurance were chargeable. It was in the interests of justice to allow the respondents' arguments to be heard in full. They were sufficiently foreshadowed in the correspondence between the parties.

[40] The first question which requires to be answered is whether the deeming provision in sub-section 471(3) applied to the facts of the case. This would occur if Mr Noble's 2007

option had been "made available" by the appellants. If that were so, the option would be deemed to have been "available by reason of an employment" in terms of sub-section 471(1). In that event there would be no need to analyse whether the option was in fact "by reason of" the employment. It would have been deemed to be so. The logical order in which to address the issue is to look at the applicability of sub-section 471(3) first.

[40] The relevant *dicta,* which explain how a deeming provision ought to be interpreted and applied, were recently considered in *Fowler* v *Revenue and Customs Commissioners* [2020] 1 WLR 2227. Lord Briggs, with whom the other justices agreed, summarised the guidance (at para 27) as follows:

> "(1) The extent of the fiction created by a deeming provision is primarily a matter of construction of the statute in which it appears.
>
> (2) For that purpose the court should ascertain, if it can, the purposes for which and the persons between whom the statutory fiction is to be resorted to, and then apply the deeming provision that far, but not where it would produce effects clearly outside those purposes.
>
> (3) But those purposes may be difficult to ascertain, and Parliament may not find it easy to prescribe with precision the intended limits of the artificial assumption which the deeming provision requires to be made.
>
> (4) A deeming provision should not be applied so far as to produce unjust, absurd or anomalous results, unless the court is compelled to do so by clear language.
>
> (5) But the court should not shrink from applying the fiction created by the deeming provision to the consequences which would inevitably flow from the fiction being real…".

[41] The purpose of the deeming provision in sub-section 471(3) is to avoid disputes, such as the present, in which there is an argument about whether a right to acquire an option was available "by reason of an employment" by providing that an option which is "made available by a person's employer" is to be regarded as "available by reason of an

employment". The wider purpose of sub-section 471(1) is to bring employment related options within the income tax regime, rather than the capital gains provisions.

[42] Mr Noble became an employee of the appellants on 16 March 2007. On 2 July 2007 the appellants granted him a right to acquire an option. That option was thereby one which was made available by Mr Noble's employers. It was thereby deemed to be available by reason of his employment with the appellants. That is exactly what a deeming provision is designed to achieve. There is no injustice, absurdity or anomaly in this. The agreement between Mr Noble and the appellants was structured in this manner. It did not require to be, but its import was, as the appellants themselves recognised in their application for a non-statutory clearance, that the option would be caught "On a literal view of s 471(3)". It is not a literal view. It is simply affording the wording of the deeming provision its plain and ordinary meaning in the statutory context. On this basis the appeal ought to be refused.

[43] If section 471(3) were to be ignored, a more difficult question would be whether the option was made available by reason of Mr Noble's employment. The arguments are straightforward. The appellants maintain that the 2007 option was made available as a substitute for the earlier 2006 Option. They rely on the FtT judge's finding "As a matter of fact" that Mr Noble's appointment as a director was not the "*causa*" of the option. Rather, it emanated from the earlier one. The respondents found on the *dicta* of Lord Denning in *Wicks* v *Firth* [1982] 1 Ch 355 at 363 – 364) that it was sufficient that the employment was an operative cause of the option, in that the employment was a condition of the grant.

[44] The authorities in this area, from *Abbott* v *Philbin* [1961] AC 352 to the present UT decision ([2020] UKUT 162 (TCC)), were recently conveniently set out by the UT in *Charman* v *Revenue and Customs Commissioners* [2020] STC 1907 (paras 65 *et seq*). Lord Denning's *dicta*

on "by reason of employment" in *Wicks* v *Firth*, with which Watkins LJ agreed, was quoted as follows:

> "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".

[45] Oliver LJ (at 370-371) preferred a simpler test contained in the question: "what is it that enables the person concerned to enjoy the benefit?". He cautioned against "too sophisticated an analysis of the operative reasons" for the benefit. This was the preference of Hutton LCJ in *Mairs* v *Haughey* [1994] 1 AC 303. He considered that a *causa sine qua non* test was too wide. He cited Lord Radcliffe in *Hochstrasser* v *Mayes* [1960] AC 376 (at 391) that:

> "… whilst explanations by eminent judges of the meaning of particular words are valuable, they do not displace the words themselves".

Carnwarth J in *Wilcock* v *Eve* [1995] STC 18 (at 29-30) also preferred Oliver LJ's formulation. He emphasised the need to avoid considering the issue by looking to see whether the benefit was some kind of emolument in the sense of a reward for services.

[46] Applying the words in sub-section 471(1), the option was made available "by reason of" Mr Noble's employment. The 2006 Option was effectively worthless by the time of the 2007 refinancing. Its existence may have prompted the use of a similar provision for Mr Noble once that refinancing package was in place, but the reason for its inclusion is of peripheral significance. The 2007 agreement was a new scheme which had been devised to revive the fortunes of the appellants. Mr Noble agreed to become director and executive chairman. He was thereafter granted the option. Had he not agreed to become a director

and managing chairman, he would not have acquired the 2007 option. As the UT held (at para [80]) one reason for the 2007 option was Mr Noble's agreement to a package of measures which included his employment. They continued:

> "[81] The employment of Mr Noble and the grant of the 2007 Option are two of the conditions of the rescue package. The grant of the 2007 Option was conditional on the other conditions (including the employment of Mr Noble) being satisfied before it could go ahead…".

That is an accurate analysis of the primary facts. In that respect the FtT judge's classification of the "*causa*" of the option as a matter of fact is an error. The cause, in the sense of whether the option was available by reason of employment, was a matter of applying the law to the facts. Looking at Oliver LJ's formulation, rather than that of Lord Denning, what enabled Mr Noble to enjoy the option was his employment by the appellants. The arrangements with Dickson Minto are not relevant to that, nor is the fact that Mr Carnegie did not secure an option for himself.

[47] For these reasons also, the appeal should be refused.

FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2021] CSIH 45
XA44/20

Lord President
Lord Malcolm
Lord Doherty

OPINION OF LORD MALCOLM

in the appeal under section 13 of the Tribunals, Courts and Enforcement Act 2007 by

VERMILION HOLDINGS LIMITED

Appellants

against

THE COMMISSIONERS OF HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Appellants: Simpson QC, Gilson Gray LLP
Respondents: Ghosh QC, R MacLeod; Office of the Advocate General

20 August 2021

[48] Part 7 of the Income Tax (Earnings and Pensions) Act 2003 is headed "Employment income: income and exemptions relating to securities". Chapter 5 of Part 7 deals with securities options. Section 471 (1) provides that the 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." The only employment under consideration is that of Mr Marcus Noble as a director of Vermilion Holdings Ltd. The First-tier Tribunal (FtT) concluded that Mr Noble's directorship was not a reason for him acquiring the 2007 Option. Reference can be made to the discussion

beginning at paragraph 99 of the judgment, and in particular at 104-106. I consider that this was the correct view on the largely undisputed background circumstances. In any event, it was a finding on a matter of fact which was available to the tribunal. (It is worthy of note that according to the judgment it was not in dispute before the FtT.)

[49] The statutory provisions should be applied in a purposive fashion and adopting a realistic view of the facts, see *UBS AG* v *Commissioners for Her Majesty's Revenue and Customs* [2016] 1 WLR 1005, Lord Reed at paragraphs 61-68. The company did not grant the 2007 Option because Mr Noble was a director. It was not a fringe benefit of his employment. The necessary financial investment in the company was conditional on both him becoming a director and his acceptance of a dilution in his existing share option. It was this requirement which caused and explains both the directorship and the 2007 Option. They were not a cause of each other. It was a matter of happenstance that the mechanism adopted involved the company at all. If Mr Noble had not possessed the 2006 Option, he would not have received the replacement and reduced 2007 Option, whether a director or not. The reason for both the employment and the 2007 Option is to be found in the terms imposed in the refinancing package. The company made him a director and granted the option in order to secure the financial investment.

[50] At paragraphs 80-82 of its judgment, in effect the Upper Tribunal concluded that everything was a reason for everything else. I am unable to accept the analysis at this passage, which was as follows. One reason for the grant of the 2007 Option was that the 2006 Option could no longer continue in its existing form. Another was that the 2007 Option was part of a package of measures which included the employment of Mr Noble. The employment and the reduced share option were two of the conditions of the rescue package. If the employment did not happen, neither would the 2007 Option. It was thus a condition

of the 2007 Option that he was so employed. Accordingly "employment as director was an operative cause in the sense that it was a condition of the option being granted. For these reasons, in our opinion the grant of the 2007 Option was available by reason of Mr Noble's employment."

[51] In my opinion the quoted passage does not follow from the circumstances surrounding the 2007 Option. The error, as I would respectfully suggest, is in the statement that it was a condition of the replacement option that Mr Noble was employed by the company; or at least in respect of what is being read into it in the context of the statutory test. If someone says I will give you X so long as Y and Z happen, Y and Z are conditions of X but not of each other. The most that can be said in respect of the replacement option and the directorship is that it is likely that one would not have happened without the other since they were both conditions of the refinancing package. This does not make the employment an "operative cause" of the 2007 Option, far less a reason for it. (On this approach it could equally be suggested that the 2007 Option was a cause of and a reason for the employment.) In a loose sense perhaps it might be said that if the outcomes are restricted to both or neither happening, then each is conditional on the other; but this would be to use the term "condition" in an attenuated sense far removed from the statutory test which requires the employment to be at least one of the reasons for the 2007 Option.

[52] In any event, as is made clear in section 471, the Chapter covers the acquisition of a securities option. On a realistic view of the facts, when receiving the 2007 Option Mr Noble did not acquire something which he did not already have. No right or opportunity to acquire something was being made available to him by the company or anyone else. On the contrary, albeit for good reasons, he had agreed to give up part of his existing entitlement. I demur from the proposition that this approach is contradicted by the parlous state of the

company at the time, the urgent need for investment, and the subsequent increase in the value of his reduced option once it was clear that the refinancing of the company was successful. No benefit was being acquired simply by the grant of the 2007 Option. What happened was a prerequisite of the refinancing. In due course, no doubt along with other factors, the injection of funds saved the company. However at the time there could be no certainty regarding any of this. And, whatever the value of the 2006 Option at the time when the company was in need of help, had he not been required to dilute his rights he would have been even better off.

[53] If either of the above propositions is correct, it follows that the terms of section 471(1) are not met. Having decided to the contrary, the Upper Tribunal did not address the submission based on subsection (3).

[54] Before the FtT HMRC founded its case, not on an application of section 471(1), but on the deeming provision in section 471(3), see the judgment at paragraphs 96-97. Subject to a proviso concerning family or personal relationships, it states that 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." The contention was that "the deeming effect of s471(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" (paragraph 106). The tribunal recognised that on a literal reading of the subsection one might conclude that tax was payable as claimed by HMRC. However it was troubled by an outcome which contradicted its factual findings. Having held that the 2007 Option was not employment related, was the tribunal nonetheless required to proceed on the basis that it was to be taxed as if it was? If yes, the taxpayer's liability would be increased.

[55] In paragraphs 117- 126 the tribunal reviewed a number of authorities on the proper approach to deeming provisions of this kind. In one of the cases, namely *Marshall (Inspector of Taxes)* v *Kerr* [1995] 1 AC 148, Lord Browne-Wilkinson observed at page 170: "The deeming provisions in section 24 (of the Finance Act 1965) do not require one to assume that the actual settlor of the arrangement was not the settlor", something which he reckoned would be an "injustice and absurdity". From its review of the cases, principally *Mangin* v *Inland Revenue Commissioners* [1971] AC 739; *Marshall* (cited above); *Jenks* v *Dickinson* [1997] STC 853; and *Harding* v *Revenue and Customs Commissioners* [2008] STC 3499, at paragraph 127 the tribunal set out the following propositions:

> "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 way and unlimited way), an unusual set of facts, and complex legislation, it may be appropriate as a matter of construction, to limit the apparently wide effect of the deeming provision; *Jenks*."

I am in agreement with this summary of the relevant case law. It is consistent with the observations of Lord Briggs in *Fowler* v *Revenue and Customs Commissioners* [2020] 1 WLR 2227 at paragraph 27.

[56] Applying this analysis the tribunal reached a decision which it considered to be not only fair and consistent with a realistic view of the facts, but also in accordance with the

intention of Parliament when enacting section 471. It avoided an anomalous outcome. The section was analysed in detail by the tribunal. Subsection (1) was identified as the lead provision, with the other subsections, including the deeming provision, existing for its purposes and being subordinate to it (paragraph 129).

[57] At paragraph 138 the tribunal observed:

> "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)."

A theme of this section of the judgment is that if a benefit is made available to an employee by his or her employer, the deeming provision elides any need to inquire into the factual question as to whether there is a link between it and the employment; but it does not follow that it requires tax to be payable on the basis of an assumption which is known to be false. At paragraph 140 the tribunal stated:

> "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."

[58] I am in agreement with this part of the tribunal's reasoning. I consider it an error to categorise subsection (3) as a separate and distinct route to taxation which is available even if it has been established that subsection (1) has no application. In terms subsection 3 operates "for the purposes of subsection (1)". The Chapter as a whole is aimed at employment related securities; in other words those made available by reason of the recipient's or another person's employment. In the bank example mentioned above the benefit was made available by the employer, but not in that capacity; not as the recipient's employer. On a literal approach it would be caught by subsection (3), but clearly it was not

made available because the beneficiary was an employee of the granter. He received it because he was a customer. On no view was it employment related. The same can be said in the present case. The company was doing no more than facilitating a surrender or dilution of Mr Noble's 2006 Option, something which was required if the refinancing was to proceed.

[59] Furthermore, as indicated above (see paragraph 52), I have difficulty with the notion that anyone bestowed a "right or opportunity to acquire" the 2007 Option on Mr Noble. Rather than him gaining a share option, it resulted in a diminution of his entitlement, and flowed from his willingness to accept this. On that basis alone subsection (3) has no application to the circumstances of the present case. In any event, and subject to that caveat, I see force in the FtT's observation, which it described as alternative reasoning, at paragraph 141 with regard to the deeming provision:

> "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 acquire the 2007 Option was not 'made available' by Vermilion as his 'employer'".

In other words, as in the bank example, if it is clear that the employment relationship is not a reason for the securities option, that reality prevails.

[60] Perhaps both aspects of the FtT's decision on subsection (3) can be traced to the same proposition, namely that 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. On this basis the anomaly which exercised the FtT (see paragraphs 115-116) is avoided. This does not rob the provision of content or purpose. It limits its application if and when it is invoked in respect of securities which are known to be unrelated to employment or where that has been established by a tribunal. Such circumstances are likely to be unusual.

[61] Not being persuaded that there was any sound basis for interfering with the decision of the FtT, I would uphold the taxpayer's appeal and restore the original order.

FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2021] CSIH 45
XA44/20

Lord President
Lord Malcolm
Lord Doherty

OPINION OF LORD DOHERTY

in the appeal under section 13 of the Tribunals, Courts and Enforcement Act 2007 by

VERMILION HOLDINGS LIMITED

Appellants

against

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Appellants: Simpson QC, Gilson Gray LLP
Respondents: Ghosh QC, R MacLeod; Office of the Advocate General

20 August 2021

[62] Immediately after the hearing I inclined to the view that the appeal should be refused. It seemed to me then that the right or opportunity to acquire the 2007 option had been made available by the appellants to Mr Noble; that the appellants were Mr Noble's employer; that the exception in s 471(3) (a) and (b) did not apply; and that accordingly the right or opportunity required to be regarded for the purposes of s 471(1) as available by reason of Mr Noble's employment. However, upon reflection and having had the advantage of reading your Lordships' opinions in draft, I have come to the conclusion that the appeal should be allowed. I am in substantial agreement with the reasons given by Lord Malcolm,

but since my views do not entirely coincide with his, and since the court is divided, I shall set out my reasons briefly.

[63] In my opinion on a fair reading of the FtT's findings it found that, looking at the matter realistically, the substance of the transaction concerning the 2006 option and the 2007 option was one of compromise and exchange. The 2007 option was granted in return for the 2006 option being given up (see in particular paragraph 45). The appellants and Mr Noble agreed that their respective rights and obligations under the 2006 option would be replaced by the rights and obligations in the 2007 option. In those circumstances the FtT was clear that Mr Noble's right or opportunity to acquire the 2007 option was not made available to him by the appellants as his employer (paragraph 141).

[64] In my opinion that was a conclusion the FtT was entitled to reach looking at the facts realistically. The right or opportunity to acquire the 2007 option was part and parcel of Mr Noble and the appellants' agreement to compromise their respective rights and obligations under the 2006 option and to replace them with the 2007 option.

[65] I do not accept that that analysis is undermined by the contention that Mr Noble's rights under the 2006 option were worthless immediately before the 2007 option was executed. In my opinion it is not correct to say that those rights were worthless at that time. The FtT made no such finding. Rather, it found that the option would have become worthless if the refinancing did not proceed (paragraph 45). If it was proposed that the refinancing should proceed the option had value. Indeed, in my view the best indication of the value of Mr Noble's rights under the 2006 option at the material time is that the 2007 option was granted in return for those rights being given up.

[66] During the hearing counsel posited a bank offering all of its customers a right or opportunity to acquire a securities option (cf. the scenarios discussed in *Steven Price & Others*

v *The Commissioners for Her Majesty's Revenue & Customs* [2013] UKFTT 297 (TC), at paragraphs 84-87). Some customers might also be employees of the bank. Nevertheless, it was common ground that it could not be said that the right or opportunity would have been made available to those customers by their employer in terms of s 471(3). 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. *Steven Price,* paragraph 84). If that is the correct approach (it is unnecessary to express a concluded view on the point) then it seems to me that here too there is no real link between the fact of Mr Noble's employment and the right or opportunity to acquire the 2007 option. In any case, in my judgement it would be anomalous, absurd and unjust if that right or opportunity were to be treated as having been made available to Mr Noble by his employer.

[67] It follows that in my opinion the facts found do not trigger the deeming provision in s 471(3). In my view the FtT was correct to conclude as it did on that issue.

[68] The remaining question is whether the right or opportunity to acquire the securities option was available by reason of Mr Noble's employment (s 471(1)). The UT concluded that it was. It reasoned that that employment and the pre-existing 2006 option were both operative causes of the right or opportunity to acquire the 2007 option being available. The fact that the employment was one of a plurality of causes was sufficient to make the right or opportunity available by reason of the employment.

[69] As I have observed already, the FtT found that the 2007 option was granted in return for the 2006 option being given up (paragraph 45), and that the right or opportunity was not

made available to Mr Noble by the appellants as his employer (paragraph 141). The FtT did not find that Mr Noble's employment was an operative cause of the right or opportunity to acquire the 2007 option. On the contrary, in my view its finding (para 105) that the *causa* was the pre-existing 2006 option strongly suggests that it regarded that as being the only operative cause. In any case, I think that on a fair reading of its findings the FtT decided that it was the existence of the 2006 option which had enabled Mr Noble to enjoy the benefit of the 2007 option (*Wicks* v *Firth* [1982] 1 Ch 355, Oliver LJ at pp 370-371). In my opinion that was a conclusion which it was entitled to reach, and which the UT ought not to have disturbed.

[70] I would allow the appeal and restore the decision of the FtT.